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S. HRG. 101-315

THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE ON SMALL BUSINESS

HEARINGS

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE ON SMALL BUSINESS

GREEN BAY AND APPLETON, WI—AUGUST 14, 1989
MANITOWOC AND SHEBOYGAN, WI—AUGUST 15, 1989
EAU CLAIRE AND LA CROSSE, WI—AUGUST 16, 1989
MADISON AND MILWAUKEE, WI—AUGUST 17, 1989

Printed for the use of the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE

23-617 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
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23-617 O - 89 - 1

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THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE ON SMALL BUSINESS

MONDAY, AUGUST 14, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Green Bay, WI.

The Committee met at 9:02 a.m. in the City Council Chambers, 100 North Jefferson Street, Green Bay, WI, Hon. Robert W. Kasten, Jr. (Acting Chairman) presiding.

STATEMENT OF BOB MILLER, MANAGER, U.S. SMALL BUSINESS ADMINISTRATION OFFICE, MILWAUKEE, WI

Mr. MILLER. Good morning. My name is Bob Miller. I am Manager of the Small Business Administration Office in Milwaukee.

We are very happy to present the official hearing for the U.S. Senate Small Business Committee, and presiding will be Senator Bob Kasten.

Bob Kasten is a Member of that Senate Committee, and the primary purpose of the proceeding, of course, is to take testimony on Section 89 of the 1986 revision of the Internal Revenue Code.

As already announced, we will proceed in a panel format, and if time should not permit, all witnesses who care to testify, to do so verbally, we will accept your written testimony, and the Senator will take it with him back to Washington for inclusion in the Congressional Record.

Ladies and gentlemen, Senator Kasten.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. Bob, thank you. Let me, first of all, say thank you to all of you.

This is a hearing of the Senate Small Business Committee and also of the Small Business Administration's Advisory Council. As Bob Miller said, Bob is the Area Director of the Small Business Administration.

We have hearings like this going on in other parts of the country with other Senators, both Republicans and Democrats, learning about different kinds of issues that are facing us.

We are talking about capital formation issues, we are talking about the capital gains tax, but today and throughout the week, I am going to be going to seven or eight different cities, having hearings—learning about the actual impact of Section 89 on small business, and schools, and municipalities.

The court reporter is here from Washington, and my staff person is here from Washington, and we are going to develop a record across the country, in order to try to figure out exactly what the impact of Section 89 is going to be.

This special hearing today is to assess the regulatory, the employment and the health-coverage impact of Section 89 of the Internal Revenue Code.

Perhaps no single provision of the new tax code has been as controversial as Section 89, particularly with small business and municipalities.

In case there are some here today who do not know about Section 89, let me just briefly outline the provision.

It is a part of the Tax Reform Act of 1986, which is designed to eliminate discrimination in employee benefits. That is a noble goal in theory, but the reality of attempting to devise a system to administer Section 89 has been a nightmare. It is complicated, it is confusing and it is having the opposite effect than the effect that was intended.

We did have benefit rules under the old tax law. Those benefit rules worked just fine. But not only did we change these benefit rules, we changed them in a way that makes discrimination more likely to occur.

Employers are now presumed guilty, or would be presumed guilty, until proven innocent. And proving that you are not discriminative is now difficult, and most importantly, costly—and that is what we hope to learn in these hearings—so costly that many employers will simply cancel health benefits, rather than put up with the headaches of ensuring compliance with all the accountants, lawyers, and other management people.

I have been leading a fight in the U.S. Senate to repeal Section 89. It is clear to me that Section 89 hurts workers and it hurts businesses, particularly small businesses. And I believe that Section 89 represents Federal redtape at its worse, and I believe we can be successful and we can win the fight for repeal of Section 89 this year.

Today, we are going to learn about how a provision of the tax code affects real businesses and real people, right here in Wisconsin.

We are going to hear about the impact the provision will have if we do not stop it—if we do not repeal it.

Many people are going to be testifying. As I say, we will travel throughout the State, to a number of different hearings, trying to develop information and real-life examples.

So I would like to thank the Small Business Administration Advisory Council for their sponsorship of these hearings, and I look forward to working with them as we develop the final record and the final product of what we do.

Now, our first witness will begin. Why don't we begin with Kramer Rock.

STATEMENT OF KRAMER ROCK, OWNER OF TEMPLOYMENT, INC., GREEN BAY, WI

Mr. ROCK. Thank you, Senator. Although I do not have any formal, written testimony today, I come to you as a small business-owner and employer of six full-time, permanent employees.

Although that sounds small, I am the owner of a temporary help firm.

Section 89, as it currently exists, may have a great impact in taking me right out of the picture.

Just as a backdrop, temporary help has been around for years and, in fact, to digress if I may, you were a key sponsor of legislation setting aside a week recognizing the impact on the economy of temporary help, which is the first week of October every year. And for that I, perhaps parochially, thank you.

Again, to just give a backdrop, the payroll, nationally, in 1988 of the temporary help industry was over $10 billion, with a "b," putting over 1 million people to work. About 200,000 people were working through temporary-help firms 18 years ago.

In fact, roughly, one out of every 105 people last year working—that is, in the nonagricultural economy—was working as a temporary employee.

Now, the impact on me as a small businessperson. Directly speaking, I have eliminated all welfare plans from my company's employment. Before that, I was able to discriminate, but in a positive way, by providing health insurance coverage for my internal staff of six people, as well as myself.

In lieu of spending umpteen dollars, jumping through umpteen hoops, I simply eliminated any health insurance benefits to my internal staff—therefore, eliminating any problem with complying.

As a temporary help firm, we are the employer of record. As it exists, any employee working over 17.5 a week, I believe it is, has to be covered, at least on a percent basis, by the Section 89 ruling.

Anybody working 30 hours, it becomes, I believe, 75 percent coverage.

The economic impact of that is absolutely breathtaking to me as a small businessperson in Green Bay, WI, particularly in our particular industry. Arbitrarily, 9 out of every 10 people working for our service are basically passing through, if I may use that expression.

On balance, they are using a temporary help firm as a means of springboarding into permanent, full-time employment.

As you can imagine, this is the same with some of the other small employers in Green Bay and throughout the United States, whether it be the local car wash or the local hamburger stand, they are facing the same problem.

The net of it, Senator, is that the cost to comply, that is to say, if compliance in my own mind was even possible, is absolutely ridiculous.

In checking with some of my peers throughout the United States, pension plans, again, ostensibly a good idea, have been totally written off and eliminated due to the problems of complying with Section 89.

Again, I feel it is a good idea possibly gone awry. Ostensibly, making sure no one is overlooked for health care, and so on, is the American way, if you will.

If I may be a bit personal here, I think Section 89, for the small businessperson, is just one more mandate we do not need. It is a burden on our back and, lest we forget, the Immigration and Reform Control Act, with the great I-9 forms of 1986. You know, INS insist's employees keep those forms for about 5 days or 5 years after Armageddon, so it is silly.

Of all nonfarm businesses 98 percent are small businesses. And we are likely to put to work the younger employee, giving those people their first shot. And if we are taken out of the picture, I just do not know what the future is going to hold.

Thank you.

Senator KASTEN. I thank you. What I think we are going to do is go through the entire panel with your comments, and then I have a couple of different questions I would like to address, and then we will go to the next panel.

So next is Dr. David Kampschroer, who is the administrator of the Green Bay Public Schools. David, greetings.

STATEMENT OF DR. DAVID KAMPSCHROER, ASSISTANT SUPERINTENDENT, HUMAN RESOURCES, GREEN BAY PUBLIC SCHOOLS, GREEN BAY, WI

Dr. KAMPSCHROER. Thank you, Senator. I am assistant superintendent for Human Resources for the Green Bay Schools.

We want to thank you for the opportunity to present a public school district's perspective on Section 89.

As you may or may not know, Wisconsin Public School Districts are required to negotiate on salary and fringe benefits as part of their negotiations process.

Consequently, we frequently negotiate insurance benefits as part of a "total package increase." It is not uncommon for one of our employee groups to request upgrades in one of the benefit insurances, while another employee group might choose to have more dollars tied to their salary increase.

Therefore, while we may bargain with both units, a total package increase of let us say, 4 percent, it would certainly not be distributed in the same manner.

In addition, should there be an impasse in the collective bargaining process in Wisconsin, we need to adhere to the criteria articulated in the Mediation Arbitration Law. Reference there is Wisconsin statutes 111.70.

And basic to this criterion would be the "comparability test." Therefore, should an employer or employee group wish to negotiate a benefit design change, our major focus would need to be on the comparability of like-size school districts or, in many cases, an athletic conference alignment by school districts.

Both of these elements would certainly fly in the face of Section 89, calling for nondiscrimination in the way employers provide health benefits.

Wisconsin's public sector bargaining law is totally contradictory to the Section 89 of the IRS Tax Code.

Thank you for the opportunity to present this information.

Senator KASTEN. Thank you very much.

When we get back to the questions, I am going to ask if you have had an opportunity to figure out how much it might cost in order for different kinds of legal and accounting fees in terms of complying.

You have what, roughly, 2,000 employees, a little bit under that?

Dr. KAMPSCHROER. Just a little hair under that. Yes, Senator.

Senator KASTEN. Our next witness is Dennis Langenberg, representing the accounting firm of Shinners, Hucovski and Co.

STATEMENT OF DENNIS LANGENBERG, CERTIFIED PUBLIC ACCOUNTANT, SHINNERS, HUCOVSKI AND CO.

Mr. LANGENBERG. Thank you, Senator.

As a partner in a local, public accounting firm of Shinners, Hucovski and Co.--it is a firm of 65 employees—I have responsibility for the employee benefits in the firm, as well as for the employee benefit planning and compliance for all of our small business clients.

I have spent more than 500 hours on Section 89 in the past year. I feel I can represent both the employer and the many small business clients that I have represented.

I have tested over 80 small business clients, and I have found that not one of those small businesses will provide additional benefits to its employees under Section 89. Not one.

One of the purposes of Section 89, when passed by Congress, was to provide more benefits to all rank-and-file employees, and that has not happened. And I believe will not happen under the current Section 89 law, as well as the new proposed laws.

In fact, of the small businesses I tested, several of those small businesses dropped their health plan, thereby covering less employees.

As Section 89 now stands, the main purpose of the law is not to provide extra health benefits to rank-and-file employees, but rather to raise taxes by taxing the discriminatory benefits to the highly compensated.

While that is a worthy goal, the calculations to determine the excess benefits to the highly compensated employees have become extremely complicated and costly.

In fact, in our own firm, we have spent approximately $40,000 to comply with Section 89. We have spent time to develop software to do the testing in-house. We have spent time to learn about the law, nonproductive time that is, because of Section 89.

One of the problems that I have run into in performing the tests under Section 89 is a general lack of guidance from Congress and the IRS.

First, an extremely complicated set of laws was passed back in 1986. The IRS was allowed 2 years to issue regulations. Not one regulation was issued in those 2 years. Instead, in 1988, Congress passed another set of laws that added on to Section 89, that further complicated the situation.

The law became effective January 1, 1989, with very little guidance and placed a tremendous burden on taxpayers to comply.

Eventually, the IRS did come out with regulations that looked like a major novel. These regulations only further complicated the law. It did not report on all aspects of Section 89.

I feel the IRS and Congress have been negligent in their duty to provide the proper guidance to taxpayers.

What has really made me mad is that employers who have complied with the law or have tried to comply with the law now have spent that time in vain.

Congress is currently considering delaying the law, with high probability, to January 1, 1990. And all time spent by employers that tried to comply with the law has gone by the wayside.

The law apparently is going to be effective, which it should not be. It should be delayed until all regulations and interpretations are issued by the IRS to provide taxpayers with guidance and also assurance that the law will be around and avoid unnecessary costs.

One of the purposes of passing Section 89 was to, besides writing coverage to rank-and-file employees, was to raise revenue.

I question whether that goal was even being met. Yes, the IRS is raising money by having excess benefits taxed to the highly compensated, but the nonproductive time to perform the calculation really nullifies those tax savings.

In fact, if an outside consultant is paid by an employer, they get a tax deduction which reduces the taxes that they pay.

So I truly believe that the resulting revenue from Section 89 is very negligible, if at all. I really wonder if it is worth the cost to tax the highly compensated in an attempt to provide the rank and file with coverage.

I do not believe a tax-approach impact on the highly compensated employees is the answer. A much different approach is needed. That approach needs to have some time consideration before being implemented.

Again, I feel the current Section 89 law, as well as the proposed laws, are not doing the job for which it was originally set up. That is, it is not, in my opinion, raising revenue nor providing more coverage to the rank and file, and it should be repealed and a new law from a different approach should be passed.

Senator KASTEN. Thank you very much.

Our last witness on this panel is Mr. Peter Boss. Peter.

STATEMENT OF PETER BOSS, RISK MANAGEMENT, BROWN COUNTY

Mr. Boss. Thank you, Senator.

First of all, I would like to recognize you and thank you for your efforts in trying to repeal Section 89. I hope that you would continue in that vein in order to eliminate the ramifications, to us in local government, of Section 89.

Basically, local governments do not discriminate in providing employee benefits. We are sitting in the public scrutiny, as you are.

We have labor contracts and other vehicles. The body in this room is a vehicle that looks at our employee benefits.

The public sector has safeguards to protect against discrimination. We have collective bargaining agreements, binding arbitration mediation law, and the Fair Labor Standards Act.

Also, local governments are responsible for providing health care service to the uninsured.

Section 89 really limits our ability to provide flexible benefit options to our employees and significantly increases the cost to the taxpayers.

Outside of repeal, we would like and request a delay in the effective date to at least our next labor-negotiation contract, and/or the 2 years that is being proposed right now. We would also like to exclude from testing certain types of employees, such as prisoners, work-study students, mental patients and leased employees.

We are a local government, 1,180 employees. We have 19 union contracts to deal with.

We have estimated initial cost to provide compliance with Section 89 between $25,000 and $30,000, and an ongoing cost in the neighborhood of $20,000 to $25,000.

Basically, in conclusion, as we see it, Section 89 was designed to generate tax revenue for the Federal Government through close scrutiny of the highly compensated employee.

We in local government have very few employees that meet the current minimum wage requirements of Section 89, and yet we are to finance the cost of nondiscrimination testing even though it will not result in increased revenue for the Federal Government or reduce the burden of the uninsured health-care cost.

Senator KASTEN. Peter, thank you.

Let me, if we can, talk about the dollars, just for a moment.

You said that it would cost you, just in the city government here, Brown County government, between $20,000 and $30,000 each year. You said between $25,000 and $30,000 the first year, and then an ongoing cost of about $20,000 a year, just to fill out the forms and comply. Is that right?

Mr. BOSS. That is correct. Our major problem is capturing the information, and it requires us to rewrite our payroll system.

Basically, we have to get a report writer-type of payroll system to capture the information that is there, and that is the major cost factor, and then the ongoing programming to keep it up.

Senator KASTEN. Have you, David, had an opportunity to think this through, in terms of what effect there would be on the Green Bay school systems in terms of how much it would cost in order to comply?

Dr. KAMPSCHROER. Our major focus has been developing the software on doing the discrimination testing.

And a consortium of major school districts in the State has been working with consultants, and it would appear, the best deal, even working with a cooperative group with the same program, would cost out at somewhere between $18,000 to $20,000 per school district, not including the data collection within our own building, which would be at an hourly cost. And that is a big question mark.

So, figure $18,000 to $20,000 on just hands-on information in a range, I suspect, of $2,000 to $5,000. So it would be very close to what you already heard.

Senator KASTEN. We are talking about that. I think it is important to point out that this is a typical school district, maybe slightly larger than some in the State, and roughly, a typical county.

So you take this across our State and talk about 72 different counties, talk about all the different school districts, it is a tremendous cost. And we are not even talking—this is a small business hearing that we are talking about, right now, the impact of municipal government and on school districts.

One of the things that we, in Washington, ought to figure out is that when people who can make money in advising their clients how to comply with the rule, as you have done, in effect, will be one of those that has their meter running for helping different kinds of businesses and municipalities.

When you come to us and say, this is too complicated, that should to be a clear signal to us, to Washington, that this law is wrong and is bad.

Do you have any sense of how much it would cost your accounting firm to comply with this. Is there any way of thinking in terms of an average, maybe like Kramer's business, thinking in terms of a manufacturing company of 15 to 25 employees.

Mr. LANGENBERG. A good rule of thumb in determining the cost that small employers will incur because of Section 89 is to take $750 as a base charge, and then add $15 per employee, so I think in your case you had 2,000 employees—you are looking at about $30,000, actually, for the cost.

But a small employer of 20 employees, take that times 15, that is 300, plus $750 you are looking at $1,000 just to do the discrimination testing.

Then the employer is also going to have to meet the qualification rules, get the plan in writing, and have an attorney draft the plan, or someone that knows what they are doing, and that is going to cost money, too.

So I think when you say $20,000, I think that is very low. I think that is very low.

Senator KASTEN. Well, one of the things that I just want to point out, and we will talk about, Kramer, your circumstances.

We now have an estimate that came from a survey that was done, from the Chamber of Commerce, NFIB, the National Federal of Independent Business, and other small business groups.

They hired an accounting—a group called the Institute for Research on the Economics of Taxation. And they did a report, and they are suggesting that Section 89 will add $4 billion to the cost of labor in 1990, going across the country. We are talking about increasing costs. These are legal fees, accounting fees, transaction costs—roughly, $4 billion in order to comply with these rules, understanding that this is a law in which you have to prove yourself innocent. We are shifting the burden of proof, and you have to prove yourself innocent, as opposed to having the IRS prove you're not in compliance.

But the cost to America of $4 billion, and they are estimating that they may pick up between $80 million and $120 million in additional revenues. The difference is that America pays the $4 billion and the IRS gets the $80 million to $120 million.

It clearly does not net out, and that is the point that you are making.

Kramer, have you had a chance to look at how much this would cost in terms of some of the people that you are working with and also with your own company?

Mr. ROCK. I have not found a solid figure, so if I could use the $15 figure. Although I have six employees internally, last year's employment provided over $700,000 in wages to the Green Bay area, and we sent out over 740 W-2 forms. Therefore, people had earned some income.

Now, let us take those 700 people, times $15, plus the base cost of whatever—I am looking at a minimum, and thankfully we are not standing still, we are growing—so as a minimum, we are looking at 15 × 7—$10,000 plus, just to show up, as it were.

Some other economic impacts; I think there is a ripple effect on this, Senator.

I have put off putting in a modestly sophisticated payroll system for the very purpose that Mr. Boss mentioned, that they would have to rewrite the entire system for the county. I protracted my purchase, in part, due to Section 98.

Now, I put that in dollars and cents to the economy. Somebody that makes a computer system and sells software is not making money. They are not hiring people. They are not putting money back into the economy.

We could go on, I am sure, but the actual impact on me—I have spent, and I am working from memory here, well over $2,000 on my CPA firm, along with sending people to seminars put on by personnel associations locally. The impact is dramatic.

Senator KASTEN. Well, first of all, let me say thank you. We are going to the next panel, but let me just make two comments.

No. 1, Section 89, will clearly not be enforced under any circumstances before the end of fiscal year 1990. So you are not going to have to deal with complying and you should not have to deal with trying to figure out what kinds of changes are going to be made.

We have now put in both the appropriations bills, in the House and in the Senate, and the Treasury postal bill, appropriating the money from the Treasury Department. None of the funds in this appropriation can be used for the purposes of enforcing Section 89.

So, although we have not been able to get the Finance Committee and the Ways and Means Committee to allow a vote on the floor—this is a procedural question in the appropriations bill, simply take the money away from the IRS in terms of their enforcement.

So that gives us a little bit over a year to work for outright repeal, and that is what we are doing. We are going to work for outright repeal.

The other point that I want to bring up is the fact that, right now in America, we do not have enough people covered in the private sector with adequate health insurance.

The Federal Government should put incentives into the system so that more employees will cover more employees with their health insurance and have those people covered in the private sector as opposed to fall through the cracks and then have to be picked up by the safety net of Medicare and Medicaid, other assistance.

Section 89 is clearly a disincentive. Section 89, as was testified here, will have people drop their plans if they can elect to do so. That would not be the case of the school system or the county.

But small business will make a choice, and they will say, I cannot afford to have these kinds of plans, and they will drop their plan completely, which will mean that employees will not be covered by any plan. And I think that is a major, major problem.

So let me thank you all very, very much for being here, and we will begin with the next panel.

Bob, do you have the names straight?

Mr. MILLER. Mr. Vondrachek, if you will come up, please? Dr. Nystrom, John Boland, and Mr. Phil Hauck.

Senator KASTEN. As the gentlemen are getting seated, I just want to say for the record that I have a number of letters which have been submitted with regard to testimony on Section 89 individuals in the Green Bay/Brown County area that are not able to appear here today but have asked that their letters and information and back-up documents be included in the record.

So I would ask at this time that we include this set of letters with regard to Section 89 as part of the Small Business Committee hearing record.[1]

Senator KASTEN. We will begin right now with Mr. Vondrachek.

STATEMENT OF BERNIE VONDRACHEK, HUMAN RESOURCES MANAGER, HOME CARE ADVANTAGE, GREEN BAY, WI

Mr. VONDRACHEK. Thank you. Thank you for being here.

I am the human resources manager at Home Care Advantage, the home health care agency in Green Bay. And we employ approximately 75 employees, some part time, some full time.

And I am here to voice my opposition to Section 89. Section 89 calls for complicated and burdensome testing procedures that are costly and very time consuming. And although I believe strongly in the need for the employee health care benefits, small businesses like Home Care Advantage are at a disadvantage because of the high legal administrative costs associated with the implementation of Section 89.

This cost will be reflected in higher charges for our services, which will make us less competitive with larger health care facilities.

Small businesses like ours will find it increasingly more difficult, or impossible to compete in the health care arena if Section 89 is allowed to stand as is, without significant modifications.

Furthermore, the fact that IRS has failed to produce clear guidelines to interpret Section 89, speaks quite pointedly to the complexity of the law.

In closing, Senator Kasten, let the Small Business Committee and the Senate know that Home Care Advantage would like to see Section 89 delayed until the issues around its complexity and high cost of implementation are resolved.

Thank you.

Senator KASTEN. Thank you for your testimony.

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[1] Material referred to appears in appendix.

We will go now to Mr. Phil Hauck, representing Wisconsin Small Business Council. Good morning, Phil.

STATEMENT OF PHIL HAUCK, CHAIRMAN, U.S. SMALL BUSINESS ADMINISTRATION ADVISORY COUNCIL, REGION 3

Mr. HAUCK. Good morning.

Senator, I really appreciate the fact just that you are here, and it is really fun and interesting to see that normal people can actually talk to our representatives in Washington.

Who I am. I—since 1985, we have published out of Green Bay the particular publication which is being passed to you, called the Wisconsin Small Business Counselor.

What it is, it goes to 3,500 businessowners around the state on a paid basis. Its purpose is to provide advice, information, counsel, expertise to small businessowners on how to operate their businesses better.

As a result of that and my involvement with the publication, and just generally, I try to stay very much on top of what businessowners think about, what they care. We are a medium for trying to share those kinds of concerns and information, and what they should do.

And we have carried a number of stories in the past on Section 89 and how to interpret it and where it stands at that particular moment.

So that is one way I am coming to you. In addition, with Bob Miller, I am Chairman of the Northeast Wisconsin Small Business Administration Advisory Council, and have kept the interest and stayed up to date on Section 89 through that and get "The Advocate" that is produced by the SBA, so it is fairly—kept up to date on what is occurring.

I am also a State officer and director of the Independent Business Association of Wisconsin, and you may already be aware of it, but at the NSBU, the National Small Business United Conference, Political Planning Conference in Denver a few weeks ago, we instructed our representative to please support repeal through that organization, and we wanted to support you on it also.

But what am I here to talk about today? And with that packet, one of the things that we have done in Counselor, back in May, is to run a survey of our membership, those who were willing to respond, on exactly what types of benefits they provide to their employees, to themselves, as owners or key managers, to their full-time employees and to their part-time employees.

And I wanted to lead you through that, because I think it will be published in our September issue, but it gives some interesting food for thought, our perspective on this whole process.

And one of the basic points I want to make is I think that if we do repeal, ultimately, Section 89, there is really a very desirable tendency of small businessowners to give benefits where they possibly can. And I think these figures reflect when they can and how they can and what they do.

Just to leaf you through it real briefly, and I have highlighted some of them, they are categorized in size of the business: One to five employees, 6 to 10, 11 to 20, 21 to 50 and 51 to 100, and 100

plus; 100 plus really is not meaningful, because we did not have that many responding.

But if you look at the others, and I highlighted the health and medical, if you take a look at that top line, but it does notice that full-timers are provided health and medical benefits at 70 to 90 percent of all businesses providing them in most of the categories. Even at 5 to 10, 70 percent of the full-timers are provided health and medical benefits; 111 to 20, 85 percent, 21 to 50, it rises to 90, and 51 to 100, 100 percent.

So when you get to the basic programs, I think there is a tendency, even in the smaller businesses, as soon as you can, as soon you can afford to, you want to do it and you do it. Regardless of any legislation, you want to take care of your people.

It tends to fall dowr dramatically in the part-timer groups, the people you use fewer and are perhaps not as critical to you in an ongoing basis. That gets down to the 10 percent range. It really is not a trend where smaller businesses, those with less than 20 and 50 employees, really do provide significant medical benefits to part-timers.

When you do get into 50 and up you will see that jumps from 10 percent to 40 percent, so you start to see, based on capacity, that rise.

And if you go lower, you start to see the impact of capacity to pay. The fact that smaller businesses really do not have the profit base, the revenue base. You do not have the leverage of enough employees to develop the profits that larger businesses can. You just do not have earnings. You are barely—you are struggling in 20 employees and fewer, and even higher than that, just running your company and trying to provide enough dollars to take care of the full-timers and yourself.

Anyway, if you will look at line H on profit sharing, you will see that very few businesses offer profit-sharing programs to either themselves or to full-timers. It is in the 25, 20 percent range, until you get to 21 employees, when all of a sudden you finally get to that leverage capability where earnings start to increase, and then, over half, or about half, of businesses over that start to provide profit sharing.

You see some of the same impacts when you look at pension plans and 401(k) plans. Smaller businesses with less than 20 employees, which constitute, as you know, 90 percent of all the businesses, cannot afford it, and these are Wisconsin companies. But once you get above 20, you get to a point where they have a willingness to, and they are trying to, and they do.

My point through all of this is that I think there really is a willingness by businessowners to provide benefits to employees, especially the key full-time ones, but the capacities to do so does not exist until you get to at least 20 employees. And above that, you are only dealing with only 10 percent of the businesses in the country, anyway.

And you do not really see it strongly until you get over 50 employees, which are only 4 percent of the businesses.

Now, that whole issue does not address the extent of discrimination on behalf of owners, but I would ultimately constitute that just the wear and tear of the burden of starting and maintaining a

small business, even as you add, if you have—in my case, we had four employees, two full-time and two part-time.

As you add employees and get up to 10 or 15, you have really got bureaucratic problems, and you start to add supervisors, there gets—a different set of problems, you are working 60-hour weeks. Ultimately, if you are going to do something that provides a little bit extra to yourself and to some of the full-timers, that is almost justifiable in how we operate today.

And the other people have discussed more, I think, how the fact that if you get into, just the problems of trying to conform, that the cost would overwhelm the potential benefits.

Anyway, but that is—that point I am trying to make is that I think that there really is a willingness beyond Section 89 existing in the country today to do that. It does not address the problem, yet, of the fact that there are a lot of uninsured businesses, and I will get to that in a second.

Point No. 2, the capacity of the small businessowner to understand Section 89 just really is not there, I do not think. I do not think that we are ever going to get to the point where, from what I have seen, and all the reading and what we have tried to do and what we have printed, and what Mr. Langenberg talked about, that the average small businessowner can even remotely start to understand how to apply it in the business.

Our time is spent providing a product, marketing it, coordinating our workforce. There is just no energy to take seminars to understand how to interpret it. We have very little money to pay an accountant $75 to $150 an hour to analyze it for us.

I already said it, I do not believe in the idea that an accounting firm at a business my size should be preparing my taxes. In our way of life, I ought to be able to do it and understand it and do it right.

So I spend 3 days every year just doing my taxes, all the different kinds, and then I submit it to an accounting firm to see if I am right or wrong, and make some changes. We send it to the IRS, and they send it back with some different changes. [Laughter.]

And I will not even get into passive investments, because there is no way I can understand that, and I am not a dummy. You know, I have been to college. I have read the expert from Cameron, the Rostenkowski bill, I went to get an MBA at Columbia University, I think like you did.

I do an awful lot in business, and there is no way—I can start reading to you some of the descriptions of what I would have to interpret, which I will not because you understand them. You are already for repeal.

But my point is that the capacity of the normal businessowner that I understand and try to deal with and try to explain rules and regulations and concepts to in my magazine—it is very difficult. The time is not there; the information is not there. I do not think the capacity to understand this and to apply it right is right.

Point No. 3, I think you have already started to hit on it and that is my last one, which is simply that what we are doing here is trying to legislate a situation by putting all sorts of restrictions and things to analyze, instead of saying, OK, here is an accomplishment we want. Here is what we want businesses to do. We want

them to provide benefits, we want them to take care of insurance, try to develop incentives that would make it really worthwhile for me, the moment I can afford it, to do so, and I would love to do it.

There is already a willingness, capacity curves. We are anxious to do it; give us the incentive to do it.

Thank you very much.

Senator KASTEN. Mr. Hauck, thank you very much.

Our next witness on this panel is Mr. John Boland, president of Medi-Burse Corp. John.

STATEMENT OF JOHN BOLAND, PRESIDENT, MEDI-BURSE CORP.

Mr. BOLAND. Our firm administrates cafeteria or flexible spending plans. First off, and this was written before I knew we would be here, I would like to thank one of your staff members, Rob Gifford, for his assistance during the month of April. He was very helpful in keeping me informed on the proposed Section 125 regulations at that time, in terms of what was happening in Section 89.

Senator KASTEN. Well, Rob is right here, so you have the opportunity to thank him in person. And thank you very much for your comments.

Mr. BOLAND. I am already aware of your views, and I certainly agree with the elimination of Section 89 entirely.

In the Bureau of National Affairs, Inc., Volume 4, No. 7, part 3, dated April 3, 1989, the IRS issued a new provision regarding cafeteria plans under Section 89. This provision was referred to as a uniform-coverage requirement.

This provision requires an employer offering a health-expense flexible spending account, to reimburse workers for a medical claim, even if it is filed at a point during the year when sufficient funds have not yet accumulated in the employees 'account.

The sheer stupidity of this proposal is beyond belief, unless, of course, they wish to abolish the cafeteria plan entirely.

Imagine an employee presenting a bill for orthodonture to his plan administrator for $2,000, when he only has $100 in his account.

Under this new provision, the employer would be left holding the bag for $1,900. To top it off, if the employee quits, the employer is stuck.

No employer in his right mind would have a cafeteria plan under these rules.

Of course, with the cafeteria plan, the Government is subject to losing large amounts of tax dollars, from the ability to pay bills, pre-tax.

But I can assure you that very few employers even believe the ability of a cafeteria plan to save both employer and employee tax dollars.

I would dare say any of the firms represented here today have a cafeteria plan.

But let us take a look at what happens to these tax savings that is lost by the Government. The individuals are offered several options to do what they please with this money.

No. 1, they can put a portion of it in a life policy. Sometimes a single mother looks at the ability to use $5 per week to purchase a

life policy through the ease of payroll deduction as a very real benefit. Moreso, because I believe very few insurance agents will take the time to discuss an insurance plan with her, knowing the premium would only be $5 a week.

No. 2, they can place the money in their retirement plan, ultimately reducing the burden of Social Security to provide for them in the future.

No. 3, they can take cash as an option in the form of an increased pay check. What happens with cash? It gets spent, it gets taxed, and not to mention it keeps the economy moving.

There are presently enough restrictions on cafeteria plans that it protects the interests of the Government. Do not strip all of the employees' incentives away by changing rules under Section 89.

Tax Management Weekly Report, dated May 1989 stated, "Repeal of Section 89 is highly unlikely because advocates of repeal in Congress have not offered proposals to recoup the approximately $150 million in revenue that the provision is expected to raise annually."

In the beginning, Section 89 was to become effective on January 1. Then, with the outcry, it was pushed off to July. With further pressure, it was again stalled until October.

Now, I have read in the Green Bay Press Gazette on July 31 that the House has voted 376 to 26 to delay Section 89 for 1 year. The House agreed 94 percent to disagree with Section 89. The mere fact that 94 percent agree on anything is a miracle in itself.

It is clear that no one knows what to do with this hot potato because no one wants to take hold of it. So let us do the easy thing and drop it.

To paraphrase a well-known author, Tom Peters, this law is bunk.

Looking at the issue of compliance, in the July issue of Inc. Magazine in an article by Jay Finnegan, stated, "Estimated cost of compliance could be as much as $5 billion."

Our business is that of administration, and we have looked at offering a service in compliance testing.

Earlier this year we worked with a national company with over 8,500 employees. We agreed that if testing was required we would offer the service at a fee of $20 per employee. This would cost the firm $170,000. As this is a tax-deductible expense, the Government will effectively lose $58,000 in taxes.

Furthermore, once the testing was done, this firm would more than likely make the changes necessary to meet compliance. Therefore, the Government would not receive any tax on the failure to meet Section 89.

If you refer back to the article in Inc. Magazine and use the estimate of $5 billion to test for compliance, and the fact that this is a deductible expense, it appears a loss of tax revenue would be in excess of $150 million. Interesting analogy.

Referring back to the Tax Management Weekly Report, that Section 89 is not likely to be repealed because there is no other alternative, I would like to offer two alternatives. They are deceptively simple, however.

The first is the suggestion of adding a tax to fuel one-tenth of 1 cent per gallon. I don't know how much it would generate, but I am sure more than $150 million.

The second, which seems to concern everybody, the national debt, is why not add a line to the Federal tax returns for both individual and corporations. This line would allow both individuals and corporations to make a direct, tax-deductible contribution to the national debt.

I am sure you would be astounded at the results that America would pull through.

Of course, these are simplistic answers. However, they could be rather intriguing.

Again, thank you for taking your time, and if it would be of any assistance to you, I would be more than happy to appear in Washington.

Senator KASTEN. Thank you very much, John.

The final member of this panel is Dr. Bill Nystrom, president, Curative Rehabilitation Center. Bill.

STATEMENT OF DR. WILLIAM K. NYSTROM, PRESIDENT, CURATIVE REHABILITATION CENTER

Dr. NYSTROM. Thank you, Senator. I appreciate your being here.

Possibly with Section 89, maybe you could lead the way in Washington in having the Green Bay Packers be in the Super Bowl this year, because that might be just as complicated.

We recognize your leadership and your desire to do something about Section 89. I represent a nonprofit organization which is a rehabilitation center working with the disabled and elderly.

Last year, we placed 160 disabled individuals back on jobs in the community, and most of these jobs were with small businesses, and we have problems with Section 89, only because employers who are reluctant sometimes to hire the disabled, find another avenue in regards to saying, "Section 89, how will that affect us?"

We have in the legislation, and I did put up at your desk here, we have at the Washington level, a meeting with IRS and DOL, Department of Labor, been able to exclude clients who are in rehabilitation programs at facilities such as the Curative Workshop, exempt from being considered under Section 89. Originally, they were, but now they are exempt.

If you look at the paper I gave you, in the Senate version, S. 1185, there is an exclusion as it relates to the services at rehabilitation facility that are provided to clients.

We are asking if something does come out of the Congress in relation to Section 89, we ask that the revised version of the proposed amendment be considered, and that is the second part there. I believe that this has been included under H.R. 1864.

Basically, what we are saying here, and the Senate did support S. 1185, with some minor changes in the amendment. It permits a facility and individuals and clients who perform or receive services at or through a rehabilitation facility to be exempt from Section 89.

What this means, many of our clients that we put up in jobs are on trial for maybe 2 weeks or 1 month. This is called transitional

employment or supportive employment, and presently, as the law is interpreted, these individuals would be subject to Section 89.

If we can get this amendment, we feel that if it is interpreted correctly, those individuals in supportive employment, those individuals who are in transitional employment from a facility, will be exempt when they are at the facility but also on job trials in the community.

So we ask that Section 89 be repealed, No. 1. If not, that the proposed amendment to Section 89 be included, which is presently in H.R. 1864.

My final two comments is that, as a nonprofit organization, we are always walking that tightrope in regards to expenses. It is difficult to say how much it would cost us to implement such a program, because of the legal fees, additional fees to try to understand it, and to send staff and consultants, and so forth, for interpretation of the law. But, certainly, it would be between $5,000 and $10,000 a year.

The main thing and final point, as I mentioned previously, Section 89 at the present time will hinder the process of finding jobs for the disabled, because the small business groups who are very supportive of hiring the handicapped, will be faced with making a decision on what may occur if they hire a disabled person and it does not work out, and to give that person an opportunity, a chance. For they are the ones that are going to hurt.

And last year, of the 160 people that we placed on jobs, they generated income of over $1 million in northeast Wisconsin. And every handicapped person we can place becomes the taxpayer.

So, I ask your leadership, in relation to the amendment, but also to appeal Section 89. Thank you.

Senator KASTEN. Well, let me first of all say that I would be, I have been and I will be, supportive of the amendment, but the fact that you get carved out does not solve the problem for the rest of the people. And it so happens that occasional rehabilitation is something that has the right kind of political power that you can get yourself carved out.

And I will continue to support the amendment as I have in the past, but the point here is that, you know, different groups getting carved out do not solve the overall problem of, particularly the one that John addressed, which is that this is a net revenue loser for the government and, clearly, for America.

And the cost to comply has—your numbers were $5 billion from Inc. Magazine. We are now saying that we are about $4 billion, but of course, no one knows exactly.

And the idea that people who have so-called discriminatory plans would keep them is nuts. What they will do is they will change them, or even more important, they will drop the plans completely.

And that is the point I would like to address, and I will begin John, if I can, with you.

Do you have any indication that people will just simply throw up their hands and say, it is not worth to have a plan, with some of the people that you have worked with?

Mr. BOLAND. Oh, yes. Especially the smaller ones—still, it is the people with maybe 20 or less employees. They are not going to go through the expense; they are struggling just to keep their business

going. They will drop faster than—as far as the cafeteria plan goes, we have met with strong resistance in starting anything this year, because people—well, let us see what Section 89 washes out to be.

Senator KASTEN. Phil, do you have any further comments to that question?

The net result here is not only going to be a tax loss, in my opinion, it is going to be a loss of employee benefits for a large number of people.

And as you pointed out, only maybe 5 or 10 percent of the companies in this country have over 100 employees. And, certainly, those numbers are roughly the same—2 percent are over?

Mr. HAUCK. Two percent in Wisconsin, yes.

Senator KASTEN. In Wisconsin 2 percent are over 100. So you have a whole group of people, the other 98 percent are going to be faced with the question, do I want to go through the cost of compliance and have these heavy penalties out there as a further problem, or do I want to just stop.

In your opinion, what are they going to do?

Mr. HAUCK. Two comments. One is, that Section 125 is the best thing going for any business that wants to put in an array of benefit plans. And Section 89, really, as he points out, really screws up the works right now, and it is what is left after 1986.

What is going to happen, and all the feedback I get, is that smaller businesses, the ones with 20 or fewer, which constitute 90 percent of the businesses, will do everything they can not to add an employee or to add them on a part-time basis that is less than the 17.5 or 25, or wherever it ends up, and make sure that they keep that person there, or they are just plain not going to pay the benefits. Maybe they will pay a little bit more in salary so the person can buy benefits on the outside, but will not be provided by the company.

Senator KASTEN. Bernie, do you have anything to add to this overall discussion about people faced with the possibility of dropping benefits completely?

Mr. VONDRACHEK. We started out 6 years ago, my wife, we felt benefits were very important to add, and as everybody has been pointing out, that if you have—if your business prospers, that you add your benefits.

The hit on adding the additional benefits, in addition to the administrative costs, would put us in a real, real bind. I don't know what we would do. But I think it would be a very severe blow to the directions we want to go as a business, extremely severe.

Senator KASTEN. Bill, do you have any comments along this line? I know you pointed out the difficulty of the potential employer for your client.

What about looking at it from the point of view of the business that you are running?

Dr. NYSTROM. Well, basically, from our business, again, with disabled in our program, we get referrals. We turned over 2,000 people last year, so we have a lot of people to consider. Our job is to get them back into the community—many of them back on jobs.

I echo here that most of the individuals that we place with employers with 20 or less employees, and to make it more difficult for

them to consider hiring our people, I think this is the main thing and our main concern.

We need everything available to us to help place these people. And if we make it difficult for the people in small businesses to hire the disabled, it will be harder to make these people independent financially, our clients.

So our people want to work. Let us make it every way possible for them to work, and I support what has been said here.

Senator KASTEN. Let me say thanks to all of you. And without objection, I am going to ask that the small business benefit status chart be included at an appropriate place in the record, along with this panel's testimony.

[Material follows:]

WISCONSIN SMALL BUSINESS COUNSELOR
BUSINESS RESEARCH CENTER SURVEY

SMALL BUSINESS BENEFIT STATUS - MAY 1989

Size of Company, Employees		1-5			6-10			11-20			21-50			51-100			100 +		
		Owners/ Key Mgrs.	Full-Timers	Part-Timers	Owners/ Key Mgrs.	Full-Timers	Part-Timers	Owners/ Key Mgrs.	Full-Timers	Part-Timers	Owners/ Key Mgrs.	Full-Timers	Part-Timers	Owners/ Key Mgrs.	Full-Timers	Part-Timers	Owners/ Key Mgrs.	Full-Timers	Part-Timers
A. Health/Medical		60%	80%	20%	50%	70%	0%	55%	85%	10%	85%	90%	10%	100%	100%	40%	85%	100%	0%
B. Dental		20%	0%	0%	5%	5%	5%	15%	25%	0%	35%	35%	10%	35%	45%	0%	35%	50%	15%
C. Disability		40%	40%	20%	10%	5%	0%	35%	35%	5%	65%	50%	10%	55%	55%	10%	35%	50%	35%
D. Group Term Life		80%	60%	20%	25%	35%	0%	50%	80%	5%	80%	80%	15%	75%	75%	20%	85%	100%	35%
E. Paid Sick Leave		20%	20%	0%	20%	50%	5%	35%	45%	0%	85%	65%	10%	45%	45%	20%	50%	50%	35%
F. Parental/Family Leave		60%	60%	0%	25%	25%	15%	10%	20%	0%	45%	45%	10%	55%	55%	35%	85%	85%	70%
% Paid, of those with Plan		67%	67%	N/A	50%	50%	50%	50%	50%	N/A	30%	30%	30%	33%	33%	33%	0%	0%	0%
G. Company Vehicle		20%	0%	0%	45%	0%	0%	35%	5%	0%	55%	0%	0%	45%	0%	0%	33%	0%	0%
H. Profit-Sharing		20%	20%	0%	20%	25%	10%	15%	20%	0%	55%	55%	15%	45%	45%	25%	50%	65%	35%
I. Pension		0%	0%	0%	0%	0%	0%	10%	20%	0%	30%	35%	5%	70%	20%	0%	0%	15%	0%
% Defined Contrib. of those w/Plan		N/A	N/A	N/A	N/A	N/A	N/A	75%	75%	N/A	33%	33%	33%	50%	50%	N/A	N/A	N/A	N/A
J. 401(k)		0%	0%	0%	5%	5%	5%	10%	10%	0%	35%	35%	0%	45%	35%	20%	50%	50%	35%
K. Keogh		0%	N/A	N/A	5%	N/A	N/A	0%	N/A	N/A	0%	N/A	N/A	0%	N/A	N/A	0%	N/A	N/A
L. Sect. 125 Cafeteria		0%	0%	0%	5%	5%	5%	0%	0%	0%	5%	5%	0%	10%	10%	0%	35%	50%	15%
Health/Medical Ins.	80%-100%	100%	80%	100%	45%	40%	–	80%	55%	–	70%	55%	60%	80%	60%	50%	35%	20%	–
Premium Pd. By Co.	75%-90%	–	–	–	30%	20%	–	5%	20%	–	30%	30%	40%	15%	30%	50%	35%	50%	–
	50%-75%	–	20%	–	25%	40%	–	15%	25%	100%	–	15%	–	5%	10%	–	15%	15%	–
	40%-50%	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	15%	15%	–
Health/Medical Ins.	$500		25%			10%			10%			5%			15%			0%	
Deductibles (Employee)	$250		25%			25%			45%			35%			35%			40%	
	$100		50%			65%			45%			60%			50%			60%	
	Weeks																		
Vacation Employment Yr.	1		6 mos.			6 mos.			6 mos.			6 mos.			6 mos.			6 mos.	
In Which Weeks Are	2		2nd yr.			2nd yr.			2nd yr.			2nd yr.			2nd yr. or 3rd yr.			2nd yr.	
Typically Earned	3		10th yr.			5th yr.			5th yr.			5th yr.			8th or 10th yr.			8th yr.	
	4		–			10th yr.			10th yr.			10th yr.			15th yr.			12th or 15th yr.	

CURATIVE WORKSHOP
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Green Bay WI 54308

EXCLUSION OF VOCATIONAL REHABILITATION CLIENTS FROM COVERAGE OF SECTION 89

- AS PASSED BY THE SENATE IN S.1185, THE LANGUAGE OF THIS EXCLUSION IS AS FOLLOWS:

"(iii) Individuals who perform services at a rehabilitation facility and --

"(I) who are holding a certificate issued pursuant to section 14 (c) of the Fair Labor Standards Act of 1938, or

"(II) who are receiving benefits under section 223 or title XVI of the Social Security Act."

- REVISED VERSION OF PROPOSED AMENDMENT TO SECTION 89:

"(iii) Individuals who perform or receive services at or through a rehabilitation facility and --

"(I) who are holding a certificate issued pursuant to section 14(c) of the Fair Labor Standards Act of 1938, or

"(II) who are receiving benefits under section 223, or title XVI and/or title XIX of the Social Security Act"

(For further information contact the National Association of Rehabilitation Facilities, Washington D.C. 703-648-9300).

(Testimony presented by Dr. William K. Nystrom, President, Curative Workshop Rehabilitation Center)

8/14/89

Senator KASTEN. And let me just say thank you to all of you for your help, and we are going to be working on this. And, I think, particularly when we start to recognize the cost/benefit—this is not a win-win, this is a lose-lose kind of a situation.

The Government is going to lose, probably the employers are going to lose, and we are going to lose tax revenue on top of it all.

Thank you all very much.

We have one more panel to come. Is that right?

Mr. MILLER. Yes. Is Mr. Gary Cleavers here, please?

VOICE. No, I am sorry, he was called out of town.

Mr. MILLER. Are you representing him?

VOICE. No.

Mr. MILLER. Is Walt Sandberg here? All right. Mr. Daniel Bollom? If you would come up, please?

Are there any others who are prepared to testify?

Will you come up here now, please, sir?

Senator KASTEN. We will begin with our final panel. First of all, Mr. Dan Bollom, Wisconsin Public Service Corp. Dan, good morning, we are happy you could be with us.

STATEMENT OF DANIEL A. BOLLOM, PRESIDENT AND CEO, WISCONSIN PUBLIC SERVICE CORP.

Mr. BOLLOM. Thank you. Thank you for coming to Green Bay.

I am the president and chief operating officer of Wisconsin Public Service Corp. Our company employs 2,500 people in northeastern Wisconsin and north-central Wisconsin. We provide benefits to all of our employees on a broad, nondiscriminatory basis.

I am also involved with a few small businesses. For example, I am chairman of the board of partner of Norlight fiber-optics, a telecommunication company headquartered in Madison. Norlight serves parts of Wisconsin, including the Fox River Valley, Illinois and Minnesota.

The company has about 60 employees, so it is a very small business.

I am also on the board of directors of the DePere Federal Savings and Loan, which is a federally chartered mutual savings and loan, located in the Green Bay/DePere area. It has four offices, and approximately 50 employees. Both entities have the same problems with Section 89 that are being discussed today.

So even though my principal business would be classified as large, I am also familiar with the problems faced by small business.

We appreciate your coming to Green Bay to hear our concerns about the IRS Code Section 89. We also appreciate your sponsorship of the Senate repealer amendment in June and your recent support in the Appropriations Committee for the hold on the IRS funds for enforcement of Section 89. Your actions have surely contributed to Section 89 changes being proposed.

We feel that repeal of Section 89 would be in the best interest of most businesses, especially small businesses.

Many of our customers are small businesses that do not have the legal expertise or other resources to cope with the overwhelming complexity of Section 89. Wisconsin Public Service serves about 32,000 customers of this size.

We are concerned that, because of Section 89, many will drop their employer health and insurance plans. This is the opposite of what the rules were intended to achieve.

While we support the repeal of Section 89, we question whether outright repeal is viable because of the political and economic issues facing the Congress.

If a consequence of repeal is mandated benefit coverages, or further taxation of benefits at the expense of employees and employers, we would prefer simplified and reasonable rules to control discrimination.

Therefore, because our benefit plans are already nondiscriminatory, we could accept the House Ways and Means Committee's modified version of the House Section 89 bill, H.R. 1864, or the Senate and Finance Committee's proposed Section 89 bill.

Even more acceptable would be a bill that incorporates the best features of each of the Committee bill's, particularly a delay in the effective dates.

In any event, we urge you to continue to work diligently for repeal or simplification of Section 89. Forcing us to meet complex rules merely to document nondiscrimination flies in the face of our efforts to best use our resources and be more productive.

We have already spent too much on Section 89 compliance. It benefits neither our customers, our employees nor our shareholders.

Thank you.

Senator KASTEN. Thank you very much.

Now, let me just say that, I should have asked this question of John and some of the other people that were on the previous panel who have had—and also the accountant. The difficulty with passing a so-called reform package, is that next year we will be tinkering with it, and the year after we will be tinkering with it. And we will be redefining what a highly compensated employee is, and we are going to be changing percentages and changing thresholds.

We might exempt people with 30 employees or less this time, but we will be going back at this time as those of you who were in these benefit packages understand.

And I think that what we ought to do is point out that the system is not broken. We have a law talking about not discriminating against highly compensated employees, and we do not need this Section 89 effort, even if the one we have passed might be a little bit easier to deal with than the one that is law now.

I think we need to repeal this so that the whole concept is stopped. And I think that we can be successful in doing that.

Mr. BOLLOM. We are just concerned what might happen is that you will attack it in a different way that is even worse than the way that you are attacking it now.

Senator KASTEN. We need your help and the help of all people across this country to make sure that we get rid of it, and we do not replace it with something that is worse.

Our last witness, and I am happy that you could join us. We were not anticipating you being here. Mr. Bert Gagnon, who is chief executive officer of Distributors Construction Supply & Equipment. Mr. Gagnon.

STATEMENT OF BERT GAGNON, CHIEF EXECUTIVE OFFICER, DISTRIBUTORS CONSTRUCTION SUPPLY AND EQUIPMENT

Mr. GAGNON. Thank you, Senator.

I did not come with any planned testimony, but I would like to answer the question you asked Dan Bollom.

First off, our company is a family owned business. We have 13 full-time permanent employees. They are 100 percent covered for all benefits, no matter who they are.

I also have two permanent time-sharing employees, and they are covered on their spouses' plans, so they do not have many benefits with us because they already have them.

But 10 years ago ERISA, which is really similar to Section 89, came through and said, we are going to protect pension plans so everybody gets equal benefits. It resulted in our company dropping our pension plan.

So I think this proves that businesses do drop benefits to avoid complex regulations. It is the only way we can get out of all of this baloney.

We will be dropping our health insurance coverage if Section 89 is not stopped.

Senator KASTEN. I thank you for your testimony. Unfortunately, I believe that you are not atypical. I believe that this is what is going to happen, and my mail is to that effect.

One of the reasons we are doing this is because we received mail from all over the State saying that, if this goes through, they are going to be forced to drop their plans.

Let me thank you both very, very much, and particularly you for joining us at the end. I appreciate that.

We are in the process, as I said at the outset, of continuing this series of hearings.

First of all, there are a number of people that have asked to have testimony submitted for the record. That testimony will be submitted for the record. It will be compiled in the overall report that we are working on.

This week we are going to be in Green Bay, Appleton, Manitowac, Sheboygan, Eau Claire, La Crosse, Madison, and Milwaukee, asking people to come and explain how Section 89 would impact them and ask public testimony and public witnesses.

I feel at the end of this time we are going to make a very strong record in terms of what is really happening at the local level, at the grassroots, and if you will, on this law.

As I said before, Section 89 will not be enforced will not be in place until at least October 1990. Between then and now, we are going to have to work with legislators, work with citizen groups, work with small business groups and, most importantly, work with groups of affected employees who are threatened with losing their health coverage plans, because of the complexity and the difficulty of Section 89.

I thank you all very much for your testimony today. This hearing is recessed.

[Whereupon, at 10:08 a.m., the hearing was recessed.]

THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE ON SMALL BUSINESS

MONDAY, AUGUST 14, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Appleton, WI.

The Committee met, pursuant to notice, at 2:02 p.m., in Appleton City Library meeting room, 225 North Oneida, Appleton, WI, Hon. Robert W. Kasten, Jr. (Acting Chairman) presiding.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. The hearing will come to order.

I would first of all like to thank all of you for being here and explain in general what this is all about. This is a hearing that is being conducted jointly of the U.S. Senate Small Business Committee and also by the Small Business Administration Advisory Council.

With us today is Bob Miller, who is the manager of the Milwaukee office for the Small Business Administration and also with us today is my Small Business staff person from Washington along with a court reporter from the Small Business Committee.

This is one of a series of eight different hearings which we are having throughout the State of Wisconsin on section 89.

A number of my colleagues are having hearings such as these in their districts during this August break, because one of the things we are trying to determine is the economic impact of section 89 on small business, and particularly the question about whether or not the health care—excuse me, the health benefit packages—that people have now will in fact be available if Section 89 goes through, or will a number of small businesses—particularly smaller businesses, but a number of businesses—be forced to drop their health insurance programs.

If that were to happen it would be a catastrophe for America. It would be a catastrophe for Wisconsin. It would be a very, very difficult, problem.

We are going to have a number of witnesses and those of you who have prepared testimony summarize. Your full statement will appear in the record as if read and we are going to compile all of these different hearings, along with information that we have received in Washington, with information that other congressmen and senators are receiving, into a report on Section 89 from across the country.

At this time I would like to introduce Bob Miller, who is the manager of the area office for the U.S. Small Business Administration. Bob.

STATEMENT OF BOB MILLER, MANAGER, U.S. SMALL BUSINESS OFFICE, MILWAUKEE, WI

Mr. MILLER. Thank you, senator and good afternoon ladies and gentlemen. We will have two witnesses at a time at this table, and I would ask, please, Mr. Jim Buhl, corporate director of human resources for Zwicker Knitting Mills if you will take one of these chairs and John Bubulz, president and chief executive officer of SECURA Insurance, and Mr. Bubulz is also a member of the Small Business Administration National Advisory Council.

Senator KASTEN. Today, as we convene this special hearing of the Senate Small Business Committee we want to assess the regulatory, the employment, and the health coverage impact of Section 89 of the Internal Revenue Code. I don't think we have had a provision that has been as controversial. What we are hoping to do is, learn more about how businesses are going to be affected.

In Green Bay this morning I should say that we have some very, very interesting testimony from the school district administrator and also from county government, because county government is affected. School districts, school boards, and school administrators are going to be affected.

This is not simply a small business problem, it is a problem that we across America are going to be faced with. We have had benefit rules under the old tax law, and I believe the benefit rules with regard to discrimination have worked, and we do not need new or additional legislation.

But not only in the process of developing 69 did we change the rules. We also changed them in a way that makes, in my opinion, discrimination more likely to occur. Employers are now presumed guilty until proven innocent, and proving that you are not discriminating is difficult and costly that many employers will simply cancel health benefits rather than put up with the headache of ensuring compliance.

This is something that we found in our mail. It is something that we are finding in the hearings. I am leading the fight in the U.S. Senate to repeal Section 89. It is clear to me that section 89 hurts businesses and hurts workers, and I believe this represents the kind of over-regulation—regulatory overkill—that we have got to work to change.

First of all, we will hear from Mr. Jim Buhl. Jim, thank you very much for joining us.

STATEMENT OF JAMES W. BUHL, CORPORATE PERSONNEL DIRECTOR, ZWICKER KNITTING MILLS, APPLETON, WI

Mr. BUHL. Thank you, Senator. I appreciate the opportunity to represent our feelings to this Committee. I have listed in my testimony several things that I feel Section 89 applies to in our organization.

One would be the testing requirements. I think the present law imposes testing requirements that are both difficult to follow, ex-

pensive to administer, and leads to a matrix of testing configurations that are if not—the easiest way to say it, difficult to follow.

To give you an example, most companies do not have the personnel or the equipment that they need, which will mean excessive costs for small organizations, or costs in an already highly competitive business.

To give you an example, Zwicker basically has six basic plans that will require to be tested. Because of the configurations of the testing requirements under Section 89 right now, our testing requirements will be in excess of 20. For an employer of our size 20 different requirements will require probably a person and a half just to concentrate on that alone.

The second point I would like to address is the relationship of Section 89 covering the Cafeteria Benefit Program. Under present proposed law the employer will assume the risk of collection of pretax dollars for expenses already paid out if the employee terminates.

I think we need to remember why Section 125 was put into effect. I feel this was an attempt by our lawmakers to encourage employers to continue their health plans. They saw that employers were now going to what I will call "cost sharing." They saw that this was becoming more and more prevalent and a burden to the employees and they saw an opportunity to give the employees some cost relief.

Imposing this risk factor is another step in leading employers to say, "Why should we continue to extend coverage for our employees with the cost going up and now the risk factor being imposed?"

The third issue is one that I think is one that people just lost sight of. The present testing provisions which include collective bargaining groups.

Being responsible for negotiations of labor contracts, and recognizing that if I were sitting on the other side of the table I would never try to negotiate any benefit issues, realizing that our lawmakers will mandate those issues and companies will not have a voice in it. A union would never want to bring them on as a negotiation item in this situation thus putting the employer at a disadvantage when dealing with organized labor.

Another point in Section 89 testing is to recognize that the employer is making programs available to the employees to participate in; not that they actually participate in them. If a company extends the opportunity to their employees to participate in the same ratio it does to their other employees, the highly compensated group, then that should be considered versus whether they participate or not.

I think Senator Rostenkowski in his new revised Section 89 program uses a standard for testing called "affordability" which I believe should be based on a percentage of the employer's contribution rather than on the fixed dollar amounts. This factor is in both Senator Rostenkowski's and Senator Bentsen's new proposals.

I think another section that we should take a look at is the hourly requirements that are being imposed upon the employer who uses seasonal employees when doing their testing.

If Section 89 goes into effect we will have an hourly requirement that mandates that those employees be counted in the testing re-

quirements, another negative. From our perspective, Zwicker Knitting Mills is a seasonal employer, and we will look at whether or not we should continue the employment of seasonal employees if this testing requirement remains.

I think the bottom line is, the majority of our customers, the majority of our competition, comes from low wage areas and our company is very concerned for the future of our business not only being in the United States but in maintaining its position in the State of Wisconsin, when our Government mandates bills which raises our cost for doing business in this area.

I thank you for the opportunity to speak.

[The prepared statement of Mr. Buhl follows:]

ZWICKER

VILLAGE KNITTER
HANSEN
EAGLEKNIT
KNIT STREET

August 14, 1989

Senator Bob Kasten
110 Hart Senate Office Building
Washington, DC 20510

Honorable Senator Kasten:

Below I have tried to summarize my testimony concerning Zwicker Knitting Mills position toward Section 89:

1. Present tax law imposes testing requirements that are both difficult to follow, expensive to administer, and leads to a multitude of matrixs and testing configurations. Smaller companies don't have the personnel and/or equipment to handle these requirements.

   Example: Zwickers presently has six basic plans that are covered by the existing law. These six plans will cause Zwickers to conduct in excess of twenty (20) different tests.

2. The treatment of cafeteria plans under Section 89 is contrary to why Section 125 was initially implemented.

   Under presently proposed law the employer will assume the risk of collection of pre-tax dollars to cover expenses already paid out. If the employee terminates, the responsibility falls on the employer to collect.

   We need to remember that Section 125 was an attempt by our lawmakers to encourage employers to continue their medical plans, recognizing that employers were placing a greater burden of cost on the employee, and allow the employees some relief from these additional costs.

Zwicker Knitting Mills / P.O. Box 1819 / Appleton, Wisconsin 54913 / Telephone 414-731-7000
Telex 910-272-1133 / Fax. No. 414-730-4229

3. Presently Section 89 doesn't differentiate between health benefits that were negotiated under a collective bargaining agreement and non-negotiated items.

   As mentioned in my letter to you on April 20, 1989, this gives organized labor a significant advantage when it comes to contract negotiations.

   I recommend all employees covered under a collective bargaining agreement be excluded from the testing under Section 89.

4. If Section 89 must stay, I recommend that the criteria for testing be <u>eligible</u> to participate vs. participating.

   This step along with elimination of union represented employees would help.

5. On the newly proposed revisions to Section 89 as presented by Senator Rostenkowski, the bills standard for testing affordability should be based on a percentage of employer contribution rather than the fixed dollar amount.

6. I believe the law should apply only to employees who work more than 1,200 hours in a calendar year. This will help both smaller and seasonal employers in maintaining costs and continuing to make jobs available to these people.

7. The effective date for non-discrimination testing and qualification rules, if Section 89 isn't repealed, should be the beginning of the plan year commencing in 1990.

The majority of Zwicker Knitting Mills competition comes from low wage Asian countries. I am very concerned for the future of our business when our government mandates bills which raise our cost of doing business.

I appreciated your time and willingness to hear our concerns and I have taken the liberty to attach a copy of my April letter to you.

Sincerely,

James W. Buhl

James W. Buhl
Corporate Personnel Director

JWB:ls
Enc.

ZWICKER

VILLAGE KNITTER
HANSEN
EAGLEKNIT
KNIT STREET

April 20, 1989

Senator Bob Kasten
110 Hart Senate Office Building
Washington, DC 20510

Dear Senator Kasten:

I'm not the greatest communicator when it comes to written dialogue, but your request for feedback on Section 89 of the Internal Revenue Code along with the high degree of frustration that our Organization feels toward Section 89 compels me to respond.

There are several key areas that concern our firm when reviewing these requirements under Section 89. Section 89 appears to be an attempt to accomplish two (2) objectives with restrictions being applied that are not congruent with these objectives. Let me try to explain.

It appears that the collection of additional tax revenue is one goal while the other objective is to establish health care coverage for those employees who are presently not being covered. One goal tries to collect money, while the other, I believe, will lead to the eventual pay out of Federal Government and employer funds. If these are truly the objectives, then we need to get the health care coverage objective separate from tax revenue.

Section 89 Tax Revenue Program also gives organized labor an advantage when it comes to collective bargaining. Unions recognize that non organized groups (office vs factory) generally have better benefits but are paid slightly less. With Section 89 incorporating all employees in their testing, the union will continue to strive for more money and hope Section 89 will force business to increase their members benefits accordingly inorder to comply with the testing results of Section 89. I can't believe this was an objective of the tax simplification Act.

Zwicker Knitting Mills / PO Box 1819 / Appleton Wisconsin 54913 Telephone 414 731-7000
Telex 910 272 1133 / Fax No. 414-730-4229

The matrix of tests that Section 89 requires and general application rules are hideous for smaller companies who don't have the personnel and/or equipment to handle these requirements.

This appears as another attempt to solidify life long employment for attorneys and/or consultants.

Make the test simple, and include only those employees who are eligible to participate and forget about whether or not they do participate. Don't make separate plans for single and family coverage, and maintain that if a plan has no significant differences from other similar programs that the plans should be considered as one.

My last point is the one that I really have no idea what the answer is other than to increase government jobs and expenses. The question is how will these tests be monitored.

I believe a small employer will have five (5) to seven (7) tests on an average, while the larger firms may have twenty-five (25) to forty (40). With these number of tests, how and who does the government plan to check all of these tests. I think the government has taken on something that they are unable to monitor, control or accomplish.

Realizing that the reduction of the federal deficit is a primary thought on your mind, as with the other senators, Section 89 reminds me of the old saying "Penny wise - Pound foolish". I do believe we will be able to collect the pennies, but I also believe, as mentioned prior, that we will be "pound foolish".

I hope this letter will help in some small way and if you have any questions or would like additional input, please contact me at (414) 731-7000, Ext. 266.

Sincerely,

James W. Buhl
Corporate Personnel Director

JWB/rlf

(L1/RLF1/26)

Senator KASTEN. Jim, thank you very much. What I am going to do is have John's statement and then there are a couple of questions that I would like to address to each of you as part of this panel.

Our next speaker is the president and chief executive officer of SECURA Insurance. John Bubolz. John.

STATEMENT OF JOHN BUBOLZ, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SECURA INSURANCE (MEMBER OF SBA NATIONAL ADVISORY COUNCIL)

Mr. BUBOLZ. Thank you, Senator. I am wearing another hat this afternoon also, and that is the chairman of the board of the Fox Cities Chamber of Commerce and I would like to make a comment wearing each of these hats if I might.

First of all, as chairman of the chamber, it has 1,200 members, most of whom are very small businesses and most of whom would be hurt substantially by Section 89.

As I think of section 89 I am reminded of a political cartoon that I saw some years ago that showed a businessman out in front of his plant, a single story plant, and he was showing a visitor his plant, and right behind the plant was an office building—a multistory office building, and the businessman said to his visitor, here in front is the plant where we make our product and out back in that office building is where we comply with Government paperwork.

I think Section 89 is another example of where the Government is foisting upon small business tremendous redtape and paperwork that will be very costly and I think that Section 89, like this political cartoon indicated, will have the opposite effect that it is intended to in that small businesses will dump their benefit programs rather than try to comply with Section 89.

The Chamber of Commerce unanimously supported a position statement calling for the repeal of Section 89 because it is complicated and burdensome and will more than likely hurt those it is intended to help and that is the lower paid workers.

So we feel very strongly that big Government has gone crazy with the enactment of this section and that those of us living outside of the Washington beltway are fit to be tied and will not be able to compete, as Jim indicated, in world competition let alone nationally, in trying to comply with this section.

So it will cause a lot of small employers to dump their benefit programs rather than to comply. It will be a nightmare for small business in the same way that the tax withholding requirement was for banks and savings and loans that you, Senator, fought so vigorously to oppose and repeal. It will have the same effect on business as that law attempted to have, and thank goodness that was repealed.

SECURA Insurance conducted an employee survey this spring and we asked our employees a number of questions on a whole range of issues and one of those was benefit programs, and they told us that they would like flexible benefits. They told us they would like a Cafeteria Benefit Program, but I am here to say and to tell our employees that we cannot possibly consider that if you would have to comply with Section 89.

As Jim indicated, it would create a maze, or a matrix, of compliance requirements with the various kinds of plans that we would have to report on, and so while we would like to consider these kinds of benefit programs and extend them to our employees we are going to have to pull in our horns and wait to see what happens.

For a company our size, and we employ about 450 people with about four or five health benefit programs, we would have to employ a full-time benefits person or else—or perhaps in addition to that go outside and hire benefit experts and consultants to assist us with that compliance. We have not put a dollar figure to this yet, but I would say it would be in the neighborhood, on an annual basis, of $50,000 to $75,000 just for our company to comply with this requirement and so we are very concerned about it and therefore we are hoping that Congress will repeal Section 89, which is a tax on employee benefits.

I would suggest that the Congress would spend their time more wisely if they were to take up your legislation, Senator, on products liability and get serious about enacting a bill on product liability and repealing Section 89. That would really, truly help small business.

Senator KASTEN. Thank you very much. Let me at this time ask to have included in the record a number of letters that we have from the Appleton area. I think some of them are through your chamber and some are from others. These are different letters that we have received from the Appleton area in opposition to Section 89, and I just want them to be made a part of the record at this point.[1]

Senator KASTEN. You talked about how much, John? You said between $50,000 to $75,000 a year just to comply. This morning in Green Bay, we had an accountant and someone who is a consultant on employee benefit plans talk about the cost also.

You are large enough that you would be able to spend that money and maybe end up complying. Putting your chamber hat on how many small businesses, 10 or fewer employees for example, do we have in this community? What do you think their response would be when they are faced with the question of $15,000 to $20,000 consulting bills in order to comply? Do you have any indication—I know in some of these letters that people have just said to me they are going to drop their plans. Is that your understanding from the survey that you did?

Mr. BUBOLZ. Yes. There would be a mass exodus in terms of Employee Benefit Programs. Our members would simply walk away from the benefits that they are now providing their employees if they had to comply with Section 89.

That kind of a cost, $15,000 to $20,000 for a small business would wipe out the profit of many of them. Most businesses are running on small margins and this would be a backbreaker.

Senator KASTEN. Jim, have you been able to do any kind of analysis of how much it might cost you, assuming you would probably have to fold your six different plans into maybe one, or maybe two.

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[1] Material referred to appears in appendix.

But have you looked at how much money it would cost Zwicker in order to comply with the regulations?

Mr. BUHL. We have done it a little different way, Senator. We looked at what we can do with consolidation, but there are some plans you cannot consolidate and you might say well, why can you not?

Unless you are going to absorb more cost—I will give you an example. We charge different premium rates for location. We have a location in New York City for a health plan. Those rates, and the expenses incurred there, are a lot greater than in a community like Appleton, WI, so we charge a higher proportion of premium for our employees there.

If we want to make it consistent—the plans are the same but we do charge different rates because of the expense factors in New York City. We would have to absorb that cost here. If we tried to consolidate different programs it means the elimination of some, versus union versus nonunion.

Historically in industry people in the office areas maybe have lower salaries but have better benefits. I am not trying to justify that. I am just saying thats a fact. We would have to probably do one of two things. Either increase the salary ranges and drop the benefit levels, or just drop the benefit levels and try to remain competitive in recruitment activity. So there is a lot of indirect cost.

To answer your question now directly, we anticipate that if we would try to handle the 20 different configurations, we would be in about $135,000 cost range.

Senator KASTEN. That would be an annual cost?

Mr. BUHL. That is an annual cost. What we would do with that probably is attach it to our product, which is already competing against the Asian market, which is a lot lower to begin with. We have to put it somewhere, because it is coming off the bottom line.

Senator KASTEN. One of the issues that is related here is at a time when we have a major health care problem—everyone is recognizing this. What we ought to be doing is adding incentives into the system so more people would be able to reach out and cover more of their part-time workers. And more people would provide more help and we would not have as many people as we now do who are part of our labor pool because it is so expensive they are not able to get in.

We should be putting incentives into the system so that more people can be included and covered. This is clearly a disincentive and what we are doing is the exact opposite of what our national public policy should be, to reach out and get more private coverage so we do not have the tremendous burden that we have in Medicare and other Government programs.

Mr. BUHL. Senator, I have had one question on my mind since this bill was introduced. Has anyone in Washington put a figure onto the number of additional people they will have to hire just to monitor this program?

I realize that they are looking to collect additional tax dollars on one hand and on the other hand trying to put in health plans, but the cost for them to administer this thing—in a letter that I wrote to you in April I used the phrase penny wise and pound foolish. They might collect the pennies, but I am afraid there are going to

be a lot more dollars spent just trying to administer this, if they can at all.

Senator KASTEN. Well we finally—and there is a report that is available on one of the back desks. At the top it says IRET briefing, dated July 24 of this year, a group of small business people along with a couple of economics people went out and hired an institute for research on the economics of taxation to do a Section 89 study.

What we were finding is that in the debate on the Floor of the Senate and the Floor of the House in our efforts to repeal this, people were saying but you do not have any facts? You just think this is what is going to happen.

Of course, they do not have any facts on the other side in terms of how much money they think they can raise. People are going to be found not in compliance and they are going to shut their plan down or they are going to fix it. I mean, they are not going to take these additional taxes forever.

So there might be a little bit of a revenue impact. They are estimating it could be as high as $120 million the first year. But after that, there is going to be no revenue because people are either going to shut their plans down or fix it so there will not be this surcharge. There will not be this gain to the Government.

But even if it were $120 million a year of revenue to the Government, it would cost the Government at least that much to pick it up in terms of the extra paperwork and the extra things they will have to go through.

But more importantly, our study said that it will cost America roughly $4 billion a year in legal fees, consulting fees, in order for everyone to put themselves through these tests. So if it were $120 million it is not a very good trade costing $4 billion. I mean, it is crazy. I do not agree with the $120 million figure anyway.

One of the things that I know your chamber and others have been working on is the ability of dealing with cost of capital and other kinds of questions and the risks of starting a small business. It would seem to me that this is just one more impediment, one more barrier, especially when you look at these costly fines, if you are not in compliance.

Has there been a discussion, John, of this with your chamber groups or other people here in terms of the barriers toward taking that first step toward becoming an entrepreneur?

Mr. BUBOLZ. We do not have a handle on that, Senator, but it is clear that that would be one more barrier that could very well prevent entrepreneurs from going into business to begin with.

We are very concerned about economic development in the Fox Cities and we want to see new businesses sprouting up and enhancing the economy of the area. We do not have any numbers or facts yet, but in surveying our membership and through the development study that we will undertake we could determine that, but it is clear that it would impede the growth of small business.

People just would not want to get into business if they had to incur that additional cost, because as I indicated before the margins of profit are small to begin with and especially on a start-up basis it would be very difficult for a business to break even, if ever, if they had to comply with Section 89.

Senator KASTEN. One of the positive things that I am working on and others of us are working on has to do with the tax deductibility of health insurance.

As you know, as a corporation you are able to deduct the cost of health insurance. If you are an individual proprietor, if you are a farmer, if you are a self-employed individual, you are not able, presently, to deduct the cost of your health insurance. You have to pay for your health insurance with after-tax dollars, which makes it much more expensive.

One of the reasons that we in Wisconsin have a large number of people or uninsured is because they were in fact farmers, or have been operating as self-employed individuals, and they have not been able to afford the cost of the health insurance.

I introduced legislation which would have the taxation treatment of your health insurance benefits be the same for individuals as for corporations. What that would mean is that you could deduct your health care premium even if you were not employed by a company that has this kind of program. What that would mean is more people would be adequately covered and we would not have this kind of crisis in terms of insurance.

Let me thank you both very, very much. We have one or two more additional witnesses. I thank you for your help, for your testimony here, and I will ask Bob Miller who is our next——

Mr. MILLER. Mr. Jeffry Knezel.

Senator KASTEN. Our next witness, as Bob said, is Mr. Jeffry Knezel, who is the president of Schenck & Associates, a CPA firm.

Let me just say by way of introduction that you, and people like you, have the opportunity of making money on something like Section 89 but if people who make money when we pass complicated regulations come to us and complain that the regulations are overly complex and complicated, we know we have gone too far.

The fact is that we have benefit consultants, we have accounting firms, we have law firms throughout this set of hearings. We have been able to have representatives of all the different professions that would benefit by helping. You are the one that would be paid, and even in these cases people are coming to us, so I greatly appreciate your testimony and I would like you to begin with your prepared statement. Thank you.

STATEMENT OF JEFFRY KNEZEL, PRESIDENT, SCHENCK & ASSOCIATES

Mr. KNEZEL. Thank you, Senator. Because Schenck & Associates is a CPA firm, I thought it would be well for me to speak on behalf of the clients that we serve who are primarily small business clients. Those are the businesses, as opposed to even firms the size of SECURA and Zwicker, most of our clients are much smaller businesses where the financial impact of this law really has a dramatic effect.

First of all, I would like to express my full support for the complete repeal of Section 89. As I said, this position has developed from our firm's experience in attempting to advise our business clients regarding the impact of Section 89, and what I would like to do is just highlight a few of the areas that we are finding are caus-

ing extreme concern to our small business clients. First of all, there is considerable confusion as to what aspects of Section 89, if any, will be enforced. Many companies have already incurred substantial expenses engaging advisors like our firm to work through the very complicated tests to determine Section 89's applicability. Other companies, on the other hand, have virtually ignored the potential consequences of the law hoping that it will be repealed or amended so significantly as to substantially reduce the cost of implementation. These companies most certainly will not be prepared to comply if changes in Section 89 are not made.

Second, several of our clients have indicated to us that they have decided that benefit plans in their companies will be dropped for all employees except the owners. These clients are willing to do this even though the owners will be taxed on those benefits, since they feel that compliance will be much more costly than paying the tax.

Third, the law as written is highly complex and confusing. Many experts cannot agree on the interpretations. Highly complex laws cause confusion and misunderstanding by both employers and employees. Such a complex set of rules will certainly result in discontinuance of plans rather than providing more benefits for employees.

My fourth point is that the requirement included in Section 89, to include part-time people who work as little as 17½ hours per week, will result, in our experience and in discussion with our clients, in companies dropping their plans with the effect that the full-time employees who previously were covered will no longer have coverage.

Fifth, as was brought out by the two previous gentlemen, all mandated benefits represent additional overhead which must be passed on to the consumer. Businesses in our country are already at a disadvantage competing with foreign companies which have significantly lower labor costs. The administrative costs, coupled with the added cost of the benefits, just exacerbate the competitive disadvantage that U.S. companies have when trying to comply with these mandated requirements.

We strongly support you, Senator Kasten, in your efforts to repeal Section 89.

Thank you.

Senator KASTEN. Thank you very much.

Let me, if I can—the law right now has been delayed until October 1989. October of this year, and it was delayed by Secretary of the Treasury Nick Brady because they could not get the regulations out.

So here we have a law in place that was supposed to begin in January 1989, and they did not have any of their regulations in place. Even now, the regulations have not been completed, and Nick Brady delayed it because of the frustration that you are talking about, not knowing what to advise people on, and our inability to work with either the Ways and Means Committee in the House or the Finance Committee in the Senate.

We have put into the appropriations bill which will be signed into law by the President probably in the middle of September, the dollars that are used to appropriate the Treasury Department and

specifically the IRS, a line saying that none of the funds in this bill could be used for the purposes of enforcing Section 89 regulations. In other words, we have gone around the Finance Committee, and said that they cannot spend any money on Section 89 during that fiscal year.

So nothing will be done on Section 89 until the end of the 1990 fiscal year, which will be October 1990. So we have at least a year for people, I hope, to rally in support of the repeal. And in the ending will be successful.

In the Senate we had 56 people who supported me on my motion to repeal. In the House of Representatives we have more than half of the Members signed on to a bill for repeal. They are co-sponsors of the bill. So as soon as the vote occurs, we will be successful.

But unfortunately there are some that are using procedural mechanisms delaying the vote and in that way it is a little bit like John said, 10 percent withholding in interest and dividends. It took us about 8 months to finally get a vote and as soon as the vote occurred we knocked it out.

In this case, we are trying to knock it out before it takes effect and that is one of the reasons so many people do not know about Section 89 as knew about 10 percent withholding in interest and dividends, because it was actually affecting them.

Mr. KNEZEL. Could I just make a comment? We were aware when we read in our tax services that this bill had been attached to the appropriation bill that would not provide any funds to the service for enforcement of Section 89.

This, however, adds to our confusion because we know that up to this point in time compliance with at least the reporting requirements—having plans and that sort of thing—still, from my information, is still required by October 1.

Well, now we have this lack of, or no funds for IRS to enforce it, but we are confused now as to whether our clients still have to try to comply with those reporting requirements and if so, we have about 1½ months for them to try to do that. Can you give us some advice as to how to advise our clients, Senator?

Senator KASTEN. I think the hope is that we are going to get between the pressure coming down from the Appropriations Committee, plus the growing pressure across America, the hope that we will get an up or down vote on repeal—straight repeal—sometime between the September 6 or 7, when we go back, and when the Senate is out of session, which will probably be in late October or early November.

So I am hopeful in some way working with Secretary of the Treasury Brady, to put out a notice that will say Section 89 in effect is null and void at least until the end of the next year.

It would be crazy for them to be filling out reports, for you to be having your clients filling out all these different kinds of reports if in fact there is nothing there to do. But I am afraid we might have done crazier things in Washington from time to time.

The question of repeal versus reform is a question that has been bandied about a bit, and there are some who say that the Ways and Means Committee, or the Finance Committee, can fix it.

I wonder if from your point of view—and you have had experience, I know, with ERISA and Keough plans and all sorts of other things, is reform enough, or do we need to simply repeal it?

Mr. KNEZEL. I would like to think that if something is not broke, do not fix it. My feeling, my personal opinion, is that although I am sure there could be evidence cited of some discriminatory practices, for example in the health benefits area, I know in our practice here in Wisconsin our clients, our small business clients, generally were not discriminating against their employees in the provision of benefits.

They needed to provide some benefits from a competitive standpoint with their local competitors, so they were providing those. My experience is—and I have done quite a bit of work in the past few years in the ERISA area, employee benefits area—that amending or reforming laws like this just lead to more complications, another thick issue of rules and regulations that have to be interpreted and understood.

I do not feel that amending Section 89 is in the best interests of employers or employees. I really strongly feel that repeal is the only answer to get us out of the bind that I see and that frankly I have had more discussion with my clients than probably any other Government-mandated proposal in a long time.

Senator KASTEN. The Small Business Committee received testimony in Washington, and I should have brought it along. There is one Section 89 compliance book that is about this thick, and the people that were testifying in Washington—and these hearings will be made a part of that record—had this big fat book and would show it and start reading through parts of it. It is wild. I agree with you, I do not think this can be fixed, because there is not a problem out there that we need to fix. The law is sufficient and the law can be enforced. Even the proponents of Section 89 are unable, in the debate on the floor of the Senate, to cite any examples of discrimination among highly compensated employee groups.

They do not have the examples, and in the study that was done they went out and tried to find examples of discrimination and they were unable to find those examples.

So it is clear to me that this is a group of people in the IRS, in the bowels of the Treasury Building somewhere there, that are cooking up this idea and it is not a problem out here across America.

Health care is a problem across America and insurance coverage is a problem across America and that is what we have to be working on. To put in a disincentive like Section 89 I think would be a serious problem.

My understanding is that we are finished with the testimony part of this. Let me just thank all of you and particularly all of you who came to listen.

This is an issue that is only beginning to be felt by people across this country. I think in this process of hearings we are going to learn more about it.

I thank you all very much. The hearing is recessed.

[Whereupon at 2:40 p.m. the hearing was recessed.]

THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE ON SMALL BUSINESS

TUESDAY, AUGUST 15, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Manitowoc, WI.

The Committee met, pursuant to notice, at 9:03 a.m. in the Manitowoc Municipal Court Room, City Hall, 817 Franklin Street, Manitowoc, WI, Hon. Robert Kasten, Jr. (Acting Chairman) presiding.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. I would like to call this hearing to order.

I would first of all say thank you to all of you who are here. This series of hearings that we are having throughout the state is jointly sponsored and jointly staffed by the U.S. Senate Small Business Committee; Rob Gifford, my representative on that Committee; our court reporter from Washington; and the Small Business Administration here in Wisconsin and most particularly their advisory counsel. The hearings, therefore, are being run jointly by the two of us.

At the same time that I am having this series of hearings, there are other members of the Senate Small Business Committee having similar hearings in their State dealing with the problems facing small business particularly with this issue of Section 89 of the 1985 Tax Bill.

We have a number of witnesses. We are going to ask you to appear in panels. We are hopeful that you would keep your prepared remarks to about 5 minutes, and then we will get into a discussion on issues and of give and take.

I also want to remind you that your entire statement will appear in the record as if read. We are going to combine all of the statements that we have received from across the State of Wisconsin, yesterday in Green Bay, today in Manitowoc, Sheboygan, going over to La Crosse, Eau Claire, Madison, and Milwaukee.

Also, in each of these cases we have had people from some of the outlying communities coming in and asking at least that their statement be made a part of the record.[1]

This record will then be combined with work that people are doing in Arkansas and other places as we develop a body of knowledge of how Section 89 really is going to impact out where it

[1] Material referred to appears in appendix.

counts, which is in your businesses, and that is the process we are doing.

It is one thing to come to Washington and to appear before a Committee staff or before a Committee, but in effect we are trying to bring the hearing here. We are trying to bring Washington here so that we get an opportunity to listen to the real feelings on some of these issues at the grassroots level.

We have with us today representing the Small Business Administration Bob Miller, whom many of you met coming in, who runs the Milwaukee office; and Kurt Charter, who is in charge of the Small Business Administration for the State of Wisconsin.

Kurt, why not first of all introduce yourself and then call up the witnesses.

STATEMENT OF KURT CHARTER, STATE OF WISCONSIN, SMALL BUSINESS ADMINISTRATION

Mr. CHARTER. Thank you, Senator.

My name is Kurt Charter, and I am the State Director for the U.S. Small Business Administration.

SBA has a keen interest in and a definite position on Section 89, and we very much appreciate the Senator taking the time. We would like to acknowledge the interest sparked by the Senate Small Business Committee, and we appreciate your coming forth to give testimony.

Senator, this morning we have six witnesses scheduled to testify, four of whom are here. I would like to introduce the four who are here and call the first two to testify.

Mr. Karl Kahlenberg is the vice president of Kahlenberg Brothers Manufacturing in Two Rivers.

Mr. Wesley Drumm is here. He is the president of Metalware Corp. in Two Rivers.

Mr. Tom Eggen is here. He is vice president of human resources of Lakeside Packing Co. in Manitowoc.

Mr. Elroy Nass is here from Lakefield Telephone Co. in Newton.

I would like to first call Mr. Nass to come forward as well as Mr. Eggen. Mr. Nass and Mr. Eggen, if you would come forward and sit at the first two chairs.

The Lakefield Telephone Co., Senator, has eight employees, and the Lakeside Packing Co. has 500 employees. Mr. Nass, if you would offer your testimony first, please. Thank you.

STATEMENT OF ELROY NASS, LAKEFIELD TELEPHONE CO., NEWTON, WI

Mr. NASS. My name is Elroy Nass. I am chief executive officer and the secretary-treasurer of Lakefield Telephone Co. I am also a committee member of the Legislative and Regulatory Committee of OPASTO, the national organization.

The address of Lakefield Telephone Co. is Post Office Box 102, Newton, WI, 53063, and we are located southwest of Manitowoc, actually a bedroom for Manitowoc.

This is a small stockholder-owned telephone company. We have 468 stockholders and 1,296 access lines. We have eight employees,

and we have health, dental, and life insurance for all of our employees.

I am appearing in opposition to Section 89 of the Internal Revenue Code because it is too complex a set of rules for testing the eligibility for the participation in medical and life insurance plans. These rules require an employer to collect and maintain a large amount of information necessary to determine whether or not the plan is discriminatory.

It appears as though if this plan would be in effect it would almost compel us to remove the insurance plans that we have because of the maintenance and upkeep for the plan.

That is the end of my testimony.

Senator KASTEN. Mr. Nass, thank you very much.

Let us go to Tim Eggen.

Mr. Eggen, welcome.

STATEMENT OF TIM EGGEN, VICE PRESIDENT, HUMAN RESOURCES, LAKESIDE PACKING CO., MANITOWOC, WI

Mr. EGGEN. Thank you. My name is Tim Eggen, vice president of human resources of the Lakeside Packing Co. Our corporate headquarters are located here in Manitowoc.

We have recently crossed the SBA's line as far as definitions of the small business. We have 500 employees, and we are growing. We plan to add another 35 full-time jobs in the next few months.

We also are opposed to the provisions of Section 89 because of the tremendous recordkeeping requirements that it will impose upon us. We have no fewer than 10 separate benefit plans that would be covered under the provisions of Section 89 as it now stands, and depending upon the final interpretation of Section 89 with some of our outlying plants at different locations, those could also be considered as separate benefit plans as well.

Now if we had to meet the same kind of recordkeeping requirements for those plants, it could cause more serious problems for us.

If there is anything that I would offer that could be interpreted as positive about Section 89, it would simply be that one of the first requirements calling for these benefit plans to be in writing is desirable and probably necessary, and also that employees should know about it.

Most of the rest of Section 89, to me, is going to impose tremendous recordkeeping requirements upon us, and I do not think it is going to accomplish what it is designed to accomplish.

If it is designed to raise revenue, I think we will spend more money enforcing the provisions of it than we will raising revenue.

That is the end of my comments.

Senator KASTEN. Let me make a brief introductory comment, and then I want to try to go through some questions that we have been asking at a number of different places of the witnesses.

First of all, Section 89 is the part of the Tax Reform Act of 1986 which sets up a regulatory mechanism in order to prove that there is no discrimination in employee benefits. The law is already on the books opposed to employee benefits, so the thrust of our hearing today is on the regulatory overkill, the additional redtape, the

additional regulations and the legal and accounting fees that are going to be required.

One of the things we are going to talk about is whether or not you have an opportunity to work with your lawyers and your accountants to find out how much it would cost annually for you to comply with Section 89 or, as you said, Mr. Nass, a number of people who are below 10 or 15 employees are simply saying we will not take the chance of failing the test and we do not have the money to spend. We therefore will cancel our plans, and those people will be without health benefits.

Section 89 is complex and complicated and confusing and I believe will have exactly the opposite of its intended effect. We have benefit rules under the old tax law which worked fine. Not only did we change them, but we changed them in a way that makes discrimination, I believe, more likely to occur.

Employers are now presumed guilty until proven innocent, and proving you are not discriminating is so difficult and, most importantly, so costly that, as I said before many employers will simply cancel health benefits rather than put up with the headaches of insuring the compliance.

We have been successful in the Senate and in the house in working to defeat Section 89. One of the questions that we are going to be dealing with today is whether it is possible to reform section 89, fix it, or simply need to repeal it completely.

I think that in that regard your suggestion of having employee health plans written and available would be a very positive suggestion, and you are the first one who has discussed that. We have to figure out if there are ways around this or if we simply want to repeal it.

I want to also thank the Small Business Administrators Advisory Council for the sponsorship of these hearings and the efforts that Bob and Kurt have made in putting them together.

Now let me begin. Mr. Nass, have you had a chance to evaluate with your accountants or your lawyers or your personnel people how much it might cost you to comply with section 89?

Mr. NASS. Jabas Associates had seminars on section 89, and they estimate that for a company our size it would cost about $6,000.

Senator KASTEN. Just to get the forms filled out?

Mr. NASS. That is correct.

Senator KASTEN. On an annual basis?

Mr. NASS. On an annual basis.

Senator KASTEN. Tim, have you had an opportunity to figure out what it would cost you with roughly 500 employees?

Mr. EGGEN. I have discussed with our corporate attorney the different fees involved and their time. I estimate between $6,000 and $10,000 just to do the background work for the documentation part of it.

I would have to hire another person to do the followup work at an estimated cost of $20,000 to $25,000 to adequately do the discrimination testing that is involved.

Senator KASTEN. So a rough estimate for a company of your size is maybe $45,000 to $55,000?

Mr. EGGEN. That could be on an annual basis, and as we grow that can only grow.

Senator KASTEN. Let me point out that what they are saying right now is that Section 89 could bring in revenue to the government of between $120 and $130 million. I do not believe that estimate, but let us give them that.

We just finished a study which is available for the public and the press run by an economic institute. It is the IRET briefing. That is the Institution for Research on the Economics of Taxation.

We did not have the other side of this question. We knew what IRS and some of the bureaucrats thought they could raise, so we did not know how much it could cost to raise that.

Well, it is turning out if you do not count the new IRS bureaucrats that are going to have to come to Washington in order to enforce Section 89. The cost to America is $4 billion of compliance with Section 89, and here is roughly $75,000 or $80,000 of that $4 billion sitting right here in front of me.

So we are talking about America paying $4 billion in accounting fees, legal fees and transaction fees in order for the Federal Government at best to collect $120 million.

I say at best because a small business, any business, has got to be crazy if they think that they are simply going to pay those taxes every time. They are either going to fix their plan or they are going to drop their plan. So they might get that $120 million the first year, but after that nobody is going to come back and pay that surcharge again.

I think the revenue estimates, therefore, are absolutely wrong, but it is important to point out that you represent a chunk of that $4 billion going to the lawyers and the accountants.

The other thing I want to point out for the public and also for the press is this issue that is not limited to business, and it is not limited to small business.

Yesterday in Green Bay, two of our witnesses were the risk management person for Brown County who is in charge of all of the Brown County employees, and the assistant administrator of the school board, the school system, the school administrator. The schools are going to be hit with it because all of their employees and all county employees go through the same thing.

Now we did not want to have county and schools represented at every single hearing, but the point is Manitowoc County would be affected the same way Brown County would, and the county and city and school governing groups all would be affected by Section 89 in the way that you have.

In your seminar, did they discuss the option of simply dropping the plans, Mr. Nass?

Mr. NASS. Well, they discouraged it, but that was the only alternative we would have if it was going to be enforced.

I understand that it is not enforced at the present time and has been given until October 1 for enforcement.

Senator KASTEN. You would not be in a position necessarily to drop your plans, but it is possible that by bringing a number of those different plans together in order to facilitate the red tape of the newer people, of the marginal people, and of the part-time people now are being covered could lose coverage? Is that possible?

I do not want to put words in your mouth.

Mr. EGGEN. That is possible. I know that we would bring our plans into compliance and spend the money and time necessary to do it. We would not drop any of our plans. Of course, economics would figure into any decision as far as future benefits that are going to be subject to these requirements.

Senator KASTEN. Our study that I referred to before came up with roughly 20 percent of the businesses in this country would drop their plan. That was after we did the census based on this study, and they hired this whole group of economists.

Let me make one comment. Because of all the controversy Section 89 has been delayed until October 1 by Secretary of the Treasury Nick Brady. He simply made the decision because the regulations had not been published because there was an uproar across America and because, frankly, he is not as convinced that this is a good plan either.

We have had some votes in the House and some votes in the Senate. In the House, we now have a majority who have co-sponsored the bill to repeal Section 89. What has prevented that bill from passing is the Chairman of the Ways and Means Committee, Dan Rostenkowski, does not want to let the vote occur; but it is going to occur.

In the Senate, we have more than half of the Senate sponsoring either a reform or repeal measures, and we have also had a couple of test votes which I have pushed. On one vote I received 56 votes, which is obviously more than half. Because of a parliamentary situation we needed a super majority. We needed to get 60 votes to prevail on that one particular vote. We are now in a position to fight for repeal in the Senate as well.

Because the Ways and Means Committee and the Finance Committee were as obstinate on this issue as they were. Some of us who serve on the Appropriations Committee put into the Appropriations Committee language about 2 weeks ago and in the House and last week in the Senate, money that is going to the Department of the Treasury. So they pay their salaries for the IRS people and all the others.

We have a provision now in both the House and the Senate Appropriations bills which says none of the money that is being appropriated can be used for the purposes of enforcing Section 89 until the end of the year. That will be the end of the fiscal year beginning in October.

So we are going to stretch it out now at least until 1990 in terms of the funds, and neither Bentsen or Rostenkowski have made an effort to take that language out of the Appropriation bills because they know where the votes are.

So I think it is fair to say it is going to be delayed, and the key is we worked to repeal it. I do not think we are going to have to worry about Section 89 in this calendar year and maybe next calendar year either.

I wanted to just ask one further question, and then we will go to the other witnesses. We have received letters from employees who are concerned. They understood either from their union representatives or their employee representatives that Section 89 will cause them to lose their benefits.

As you pointed out, you are likely to drop yours. Have you had discussions with your employees about the danger that Section 89 puts them in terms of their health insurance benefits?

Mr. NASS. No, we have not. I understand that if you have a collective bargaining agreement, you are not subject to Section 89. This is the information that we have had; and we have had no collective bargaining agreement, so we would not be affected by it, but we have not mentioned it to our employees at all. Hopefully, it will be repealed or extended.

Senator KASTEN. Have you had any discussions with your employees, Tim?

Mr. EGGEN. No, we have not. We think it is premature at this point because the situation has changed enough over the past year that we do not feel comfortable communicating it at this point.

Senator KASTEN. Well, it is going to change. As I say, if we are lucky we are going to be successful in repealing it. Clearly, the pressure for repeal is forcing Bentsen and Rostenkowski to move on reform. No matter what, we are going to have a better law, but I fell very strongly that we have to go for repeal, not for reform.

Let me say thank you to both of you.

Kurt, who are our next witnesses?

Mr. CHARTER. Senator, the next witnesses are Mr. Karl Kahlenberg, vice president of Kahlenberg Brothers Manufacturing; and Mr. Wesley Drumm from Metalware Corp. If you gentlemen would come forward.

Senator, Mr. Kahlenberg has 35 employees, and Mr. Drumm, president of Metalware Corp., has 110 employees.

Senator KASTEN. Karl, why not begin with you. If you could give us a brief statement, and then we will go to Wes, and we will have a little dialogue as we did before.

STATEMENT OF KARL KAHLENBERG, EXECUTIVE VICE PRESIDENT, KAHLENBERG BROTHERS MANUFACTURING, TWO RIVERS, WI

Mr. KAHLENBERG. OK. I am Karl Kahlenberg, executive vice president of Kahlenberg Brothers and the comptroller there.

As you have already been informed, we are a small company of 35 employees. We spend over $57,000 a year for just our health insurance program alone, and as a company we are completely opposed to and hope for the repeal of Section 89. We do not feel that we need any more bureaucracy paperwork.

We are a company that employs skilled people. We have dealt with the Government on Government contracts. We are making the horn for DDG 51 Bath Iron Works. We have probably 10 to 12 inches of paperwork before we were able to ship the first horn. It took 3 years.

Believe me, when you are a small company and you have maybe five or six skilled people in the front office, paperwork is of vital concern to us. To us, Section 89 would mean another employee, a minimum of at least a $40,000 expense and just more bureaucracy and more paperwork.

We believe in free enterprise. We believe in making a profit. We believe that the profit system is what made this country great and

that capitalism is ideal. We have labor negotiations. We have a collective bargaining agreement with the International Association of Machinists and Aerospace Workers, and we see no reason why the Government should intervene in our health program whatsoever.

We feel that it is foolish to spend $4 billion to collect $120 million, and no business can operate that way. The only people that can operate under a deficit is the Federal Government. They have been doing that for years, and it is time we have a valid balanced budget.

That is my comment on the issues.

Senator KASTEN. Thank you very much.

Mr. Wes Drumm.

STATEMENT OF WESLEY DRUMM, PRESIDENT, METALWARE CORP., TWO RIVERS, WI

Mr. DRUMM. Thank you, Senator.

Metalware Corp. has an unusual problem. We have Metalware Corp. in Two Rivers and 2 years ago acquired Monarchware in Algoma. The company was a small company basically ready to go out of business and be closed up. We rescued it, bought it and put it as a wholly owned subsidiary.

Metalware, as you know, in Two Rivers has approximately 75 to 100 employees at different times of the season. Monarchware in Algoma has 32 people.

My understanding through the knowledge of my attorneys is that I have to have the same hospitalization type plans in Two Rivers as well as Algoma and also the same type of payment plan, and so forth.

Going over my numbers yesterday, the bargaining unit in Two Rivers pays $2 per month for their hospitalization. When we acquired the company in Algoma, the employees there paid 50 percent of the cost. If Section 89 would go through, it would cost Algoma approximately $22,000 per year just to give the same benefits for the Algoma plant as well as the Two Rivers plant.

Algoma today is not making that kind of money, and we consider it basically a separate operation and want to carry the benefits separately. Because of the rules, we are 40 miles away and in relatively almost the same type of business, so therefore we have to carry both plans there. If we went to $2 for the 32 employees there, it could cost the company $22,000. Last year's profit at Algoma was just about $20,000. So it would be basically wiping it out to a break even only or a small loss.

We also have the same problem with our profit-sharing in Two Rivers. We would have to share our profit sharing with the plant in Algoma. If they are making no money and the Two River plant is making money, I would have to share, take my profits out of Metalware and put it into the Algoma plant. This I do not feel is fair, also.

I feel because it is a wholly owned subsidiary run as a separate operation with their own P&L statements, they should not have to be dealt with in the same plan that we are. This is my comment.

In our profit sharing plan, we are planning to have a 401(K) making less corporate contribution which would be a better arrangement than having to share our profit sharing plan.

Thank you, sir.

Senator KASTEN. Thank you very much.

We touched on some of the questions.

Karl, when you said that you would have to hire an additional employee, that was, you said, about $40,000 you would estimate. What do your lawyers and your accountants talk about in terms of how much it would cost, or have you had the opportunity to review how much it would cost you in legal and accounting fees?

Mr. KAHLENBERG. I have talked with both our corporate attorney and our CPA counsel, and they feel that the cost from a legal and professional standpoint would run between $10,000 to $12,000 a year just for their counsel alone and interpreting the regulations. We would have to hire specialists that would handle this matter.

Senator KASTEN. Wes, have you had any sense of this?

Mr. DRUMM. No, I have not sat down and put pen and pencil to what it would cost for administration. I have not done that. I just did the number here what it would cost directly which I see now.

I have talked with them. Thank goodness I could feel the wave coming, and I was not going too far right at this time. I felt that people like you were trying to rescue us from getting stuck with it, so I held off.

Senator KASTEN. One of the things that has been interesting, particularly yesterday in Appleton where we had a CPA testify and in Green Bay we had a benefits coordinator, who deals with benefits. Both of them are going to make money because Section 89 is so complicated that you are going to have to hire consultants and accountants.

Notwithstanding the fact that they would both profit by the complexity and the redtape because they would get the work, they and their professions are opposing Section 89. When the people who are going to make money on the process come and tell us it is too complicated, you know we have gone over the line somewhere.

The fact is that this has very little support except for inside the beltway with a bunch of people from IRS and Treasury who do not understand what is going on in the real world.

Are you far enough along to know that if something like Section 89 took place, would you work to maintain your benefit plans or would you possibly be forced to reduce them or drop them?

Karl.

Mr. KAHLENBERG. I think that we would have to analyze the overall impact, and with that realization, knowing that our current cost just on our health program alone is $57,000 a year, that is like having another member of your management team. We would have to take an awful hardline look at the situation, and it would be subject, of course, to labor negotiations.

We have to keep ourselves in this competitive world. If our costs keep going up, they are passed on, of course, to our customers. If our product is too costly, regardless of its quality, it will force us out of business.

So if it comes to a decision of going out of business or reducing employee benefits, employee benefits will be reduced.

Senator KASTEN. Wes, I understand the special situation you find yourself in with the newly acquired company which makes it even more complicated.

Mr. DRUMM. Yes, it does make it more complicated. I have not seen my attorney's bill yet, but when I ask them this question it does screw us up because of another problem. We have two negotiated contracts in the Two Rivers operation plus the management team.

In Algoma we have no contract and we are all the same, so I have to put my management in with my factory plan, my insurance and my profit sharing.

So it does make a complicated mess.

Senator KASTEN. Let me first of all say thank you to both of you, and at this time I would like to put in the record a number of letters and statements from individuals who could not be here to testify but who wanted to be on record as part of the Manitowoc hearing.[1]

Senator KASTEN. I think it is important, and I want to simply say this to the public and to the press. The group of letters here are very, very important for this community. We not only have a number of small- and medium-size businesses, but here is a letter from Big Brothers/Big Sisters of Manitowoc opposing Section 89, "as the rules are so technical and complex that many businesses, including my own, may be forced to cancel coverage." That is Big Brothers/Big Sisters.

We have a strong letter from Memorial Hospital as to the problems that would be created for them.

We have a letter from WOMT radio as to the problems that would be created for them.

Here is a letter from Wisconsin Fuel & Light Co.

So the point is that this is going across the entire gamut of this community, and it is not simply a small business problem or even a business problem particularly with regard to some of the not-for-profit groups and some of the people who are not directly in business.

Mr. DRUMM. One quick question, Senator. We also are trying to do international business, and we have international people coming in, the guys from the Far East, competing with us who do not have these kinds of plans and do not have these kinds of rules. It is getting worse and worse and worse.

Mr. KAHLENBERG. I would like to second that, Senator. In Japan the government picks up all the health insurance costs. To us, one of the biggest things that we look at in industry is our health insurance cost.

Outside of the $57,000 for the health program, we also have a dental program, we have workmen's compensation and all of these things, and it does affect our product cost. We, too, are competing in the international market.

One of the ways we are able to compete is through C&C machines and by reducing the number of employees and increasing our productivity and looking for efficiencies. So we are certainly

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[1] Material referred to appears in appendix.

not looking for more paperwork and more bureaucracy to hamper our business.

We are struggling to survive now. We have beaten the Japanese over in Greece in the horn market with Japanese C&C machines, we are proud to say. In fact, we exported over 400,000 to Greece. We are very proud of that.

Senator KASTEN. Let me thank you both for your testimony.

I believe that we have one more witness. Kurt, why not introduce them.

Mr. CHARTER. Yes, we have one remaining witness, Mr. James Walker. Mr. Walker is comptroller for the Imperial Eastman Division of Pullman Co. here in Manitowoc. My information indicates that they have 600 employees.

Mr. Walker, if you would come forward.

If you would permit me to comment, while we have some seeming relatively larger employers testifying, the sheer cost of this on any employer is staggering and more staggering in sheer numbers as you have larger numbers of employees. Certainly, everyone recognizes that the cost per employee at a small business is just overwhelming. Thank you for coming.

Senator KASTEN. Mr. Walker, I also want to say thank you for coming. Frankly, we are trying to get as broad a cross-section as we can in terms of how this impacts. You would not normally qualify as a representative of a small business before the Small Business Committee, but neither would the School Board of Brown County.

What we are trying to do is develop under the overall umbrella of the Small Business Committee hearing as much information as we can. You employ 600 but your larger corporation, the Pullman Co., has to employ thousands; is that right?

Mr. WALKER. That is right. We employ 28,000.

Senator KASTEN. We are hoping to get a perspective, first of all, from you here in Manitowoc, and then we also might be able to talk a bit about how this fits in the overall corporation. I do not know if you are going to be able to work with us on this question.

So please go ahead with your prepared testimony. We welcome you.

STATEMENT OF JAMES WALKER, CONTROLLER, IMPERIAL EASTMAN DIVISION, PULLMAN CO., MANITOWOC, WI

Mr. WALKER. OK. I did not prepare a lot of testimony because I was not sure what the format of this hearing would be. I can tell you I have a much different perspective on Section 89 than the other witnesses that I heard this morning.

As a much larger company, we are in a different situation. The basic intent of Section 89, as I understand it, is not generally objectionable to me or my company. We do not have a problem with discrimination in favor of highly compensated employees. In fact, our plan is intentionally discriminatory against highly compensated employees, and I believe it was with the specific intention to be in compliance with Section 89.

I was not involved in the design of our health care plan which was implemented the first of January of this year, but it is so clearly nondiscriminatory that the data collection and testing re-

quirements of Section 89 are clearly not necessary in my mind. Yet, we are forced to go through these ungodly data collection and testing procedures to prove that our plan is not discriminatory.

You earlier talked about CPA's and lawyers and benefit consultants who had testified against Section 89. I, myself, am a CPA with a master's degree from Northwestern University. I find Section 89 to be offensive to my sensibilities, extremely difficult to understand and an administrative nightmare, to say the least.

The costs to our company in comparison to the cost to a smaller company is clearly not nearly the issue that it is to smaller companies, but nevertheless it is an issue and it is something that I would welcome the opportunity to reduce.

Senator KASTEN. Overall, in your work as controller you have to work with this whole problem of Government compliance, Government paperwork, and all the different other programs. I do not want to put words in your mouth, but my judgment is whenever we start in on one, whether it is ERISA or 401(K)s or Keoughs or whichever, we have a tendency to tinker around the edges even if we call it reform or simplification.

With that as a premise, am I right in saying that even if we were able to put together some kind of a Section 89 reform that would maybe be acceptable this year, is your experience such that the Government would be likely to make it worse afterwards?

Mr. WALKER. There is not much question in my mind that that would be true.

I believe that, generally speaking, we would be better off with a status quo than with so-called "reform." Generally speaking, I look at "reforms" as the latest version of the accountants' and lawyers' and, in this case, employee benefit consultants' full employment act, and it's nonproductive use of resources. I am opposed to it.

Senator KASTEN. Have you had any discussions with your people at your corporate parent company with regard to Section 89? Is there any additional insight that you can give us from the point of view of the Pullman Co.?

Mr. WALKER. I had some brief discussions with our vice president of human resources yesterday. His comments were basically that we had gone through the efforts and spent the money on lawyers and accountants and benefit consultants to be sure that we could comply with Section 89.

Our ongoing objections are to the testing and reporting requirements, but our company's policy is to provide good and competitive health care benefits to employees on a nondiscriminatory basis. We do not have a problem with that objective of Section 89.

Senator KASTEN. To your knowledge, there have been no complaints in the past about any kind of discrimination with regard to your plans?

Mr. WALKER. I have not heard of any complaints in our company.

Senator KASTEN. One of the interesting things we have found is there are virtually no complaints about discriminatory plans across the country. In other words, there is no problem out there except in the minds of some of the people at IRS.

This is not a problem. This was brought up, and essentially the genesis of Section 89 was in the Tax Reform Act of 1985. At one

point some wanted to tax all employee benefits. They wanted to tax the Midwest Express stewardesses' flight for vacation. They wanted to tax the tie or the suit that you could buy at 20 percent off if you worked at the local menswear store. They wanted to tax all employee benefits including health insurance.

The Committee said we do not want to do that. They ended up by saying we have to make sure there is no discrimination. Work it out at the staff level with the IRS. That is how we got to where we are.

Now even the authors of Section 89 are saying we did not know what the staff wrote along with the work that they did for the IRS and people at Treasury, so the people are denying it. That is how it happened. No one read this part of the law. Everybody was concerned about what the rates were, 28 percent and 15 percent and all the other kinds of things you were working on, and they simply did not pay attention.

Now we have some of these people dug in and saying even though we are not sure, what we are going to do now is just fix it a little bit around the edges because we still have a good idea here; we might be able to pick up some revenue.

That is how it began, and that is why it is here, and that is why I think we could be successful in knocking it out. Right now, no elected official is taking responsibility for the fact that it is in there. We are going to be successful in knocking it out.

Mr. WALKER. I hope so.

Senator KASTEN. Let me say thank you for your testimony. I already put the Manitowoc letters and additional testimony in the record. It is my understanding that we have no further witnesses.

Yes?

Mr. WILLIS. May I testify just briefly?

Senator KASTEN. Sure. Why not quickly introduce yourself, although we had a chance to introduce ourselves in your office just a moment ago.

STATEMENT OF PAT WILLIS, CITY ATTORNEY FOR THE CITY OF MANITOWOC, WI

Mr. WILLIS. My name is Pat Willis. I am the city attorney for the City of Manitowoc. I apologize for not preregistering or whatever I might have been able to do. I had pretrials this morning.

I am the labor negotiator for the City of Manitowoc. I and a number of other labor negotiators from municipalities in the Fox River Valley have talked about the fact that you would be conducting these hearings, and we did all agree that we have some concerns to express and that we would express them when you came to our city.

The City of Manitowoc has approximately 300 employees, and virtually all of our nonsupervisory employees are covered by collective bargaining agreements. We have six collective bargaining units, and we all are subject to the same health insurance plan.

Our primary concern relates to the reporting requirements. We do not feel that we are going to be subject to any discrimination claims, but we received a barrage of solicitations in the mail from consultants who would be happy to take our money to conduct a

study that is contemplated by the law. We feel it would be a waste of taxpayers' money to go through this.

As a matter of fact, looking over our benefits, the one difference that we have is that the police and fire departments have paid dental insurance but the supervisors do not have it. The only question I got was does this law work in reverse? Will it force the city to pay its supervisors benefits that have been negotiated in collective bargaining agreements?

I think the existence of that situation demonstrates that for those employers whose employees are represented who have collective bargaining agreements, there is especially no need for a law like this. The collective bargaining units are more than able to protect themselves and in many cases achieve benefits for their employees that may be above and beyond what supervisors, unrepresented people in this same company, have.

In conclusion, I think that at least in the case of public employee units—and those are the only people I can speak for—the private sector people have done a good job expressing their concerns today.

As a unit of Government we agree with everybody else that it would be a waste of money and in this case a waste of taxpayers' money to conduct a study which is not likely to result in any change in anyone's benefits.

Thank you.

Senator KASTEN. I thank you, Pat, very much. I know you have a busy morning, and I thank you for coming here today.

Your statement is very similar to the statement that was given to us by the person in Brown County who is running the risk management part of their business. It is an unnecessary expense and in this case an unnecessary taxpayers' expense, which takes it kind of one more step out.

We thank you very much for your participation this morning. Thank you all.

There will be one more individual. Would you like to come up?

VOICE. I did not register outside the door. May I speak to something other than Section 89?

Senator KASTEN. After the hearing is over I will speak to you about something other than Section 89, but we need to keep the hearing officially as part of this particular issue.

So if we have no further comments on Section 89, let me thank all of you, understanding that this whole hearing will be transcribed and combined with the other hearings that I am having across the state and other information gathering hearings that other Senators and Congressmen are having in their own states.

I hope we can make a case with examples such as this for repeal, and right now I am optimistic that we will.

This hearing is recessed.

[Whereupon, at 9:48 a.m. the hearing was recessed.]

THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE ON SMALL BUSINESS

TUESDAY, AUGUST 15, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Sheboygan, WI.

The Committee met, pursuant to notice, at 2:10 p.m. in the City Council Chambers, 828 Center Avenue, Sheboygan, WI, Hon. Robert W. Kasten, Jr. (Acting Chairman) presiding.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. Let us call this meeting to order so that we can start to take notes.

Let me first of all thank you, Dick, for your kind comments and also for being here. I know you are very interested in business development, particularly small business, and that is what we are talking about here today.

This hearing is a combination of a U.S. Senate Small Business Committee hearing on the one hand, which is why we have the court reporter and the staff from the Senate Small Business Committee in Washington, and a hearing which involves the Wisconsin SBA Advisory Council. Kurt Charter is in charge of the Small Business Administration. Bob Miller who is standing there is in charge of the Small Business Administration for this region.

The record of this hearing will be part of the record that we have been building on Section 89. We in the Small Business Committee have been building a record on Section 89. We have gone back to the people at IRS and Treasury in part because what we have done and the testimony that we have received in Washington is that Section 89 has been effectively delayed. We are going to talk a little bit more about that as the hearing goes on.

This week and next week a number of other of my colleagues from other countries, both Republicans and Democrats who are Members of the Small Business Committee will also be holding hearings in their States. Our purpose is to get through the kind of beltway problem that we have with the IRS and the Treasury and the bureaucrats, and people who are going to have to be dealing with these forms and dealing with the regulations and dealing with the fines are in fact facing some of the questions and the problems.

What we intend to do is around the country in effect build a record so that we can be successful in dealing with Section 89.

So the meeting today, the notes and the minutes of the testimony will be included in overall Section 89 hearing notes that we will be presenting to the Small Business Committee.

This is a special hearing. We have had a series of hearings in Wisconsin. As Dick mentioned, we were in Appleton and Green Bay, yesterday in Manitowoc and now here in Sheboygan and going to Eau Claire and La Crosse and Madison tomorrow and ending up in Milwaukee on Thursday. So we will have eight different hearings.

In each hearing, the format is roughly the same. We have asked four or five people to come and prepare at least preliminary testimony. We remind you that your full testimony will be included in the record as if read, and it is OK if you want to abbreviate your testimony to 4 or 5 minutes so there will be more time for questions.

At that point, after the people who have prepared statements have testified, we might invite Derk and some others who have some ideas and some other people who might have some particular things to say, and we would be happy to listen to other members of the public on the issue of Section 89.

We want to hold the scope of this meeting to Section 89, notwithstanding the merits of request for some funds for the marina.

So the purpose of this special hearing is to assess the regulatory impact, employment impact, and the health coverage impact of Section 89 of the Internal Revenue Code. As all of us know, this has been very controversial.

In case there are some people here who do not know about Section 89. Section 89 is the provision of the 1986 Tax Reform Act which designed a series of tests which employers must go through in order to prove that their health plans are not discriminatory.

I say that there is no evidence that there are significant numbers or even any health care plans that are in fact discriminatory in Wisconsin or across the country.

Section 89 is complicated. Section 89 is confusing. We believe that Section 89 could have the opposite effect of what originally was intended; to extend health coverage out.

We had benefit rules under the old tax law which worked just fine. Not only did we change them, but we changed them in a way which I believe makes discrimination more likely to occur. Employers are now presumed guilty until you prove yourself innocent, and it is also now so difficult and costly that in letters that we have received in Washington and committee testimony that we received in Washington and also over the 1½ days there are now indications that many employers will simply cancel health benefits rather than put up with the headaches of insuring compliance. That is obviously wrong.

What we wanted to be doing right now in the United States of America is have more people covered under broader health coverage so fewer people would be covered under Medicare and other public programs. We want incentives in the system so people would provide health care coverage.

Section 89 clearly is a disincentive, and it is going to be working for the opposite effect.

I am working in the Senate to repeal Section 89. We have had two or three votes. I believe we can be successful. In the House of Representatives we now have more than half of the Members of the House of Representatives signed on as sponsors or co-sponsors of the Section 89 repeal.

I was talking to a couple of my banker friends, and I said this is not unlike 10 percent withholding on interest and dividends on your savings account that we went through a couple of years ago. It was clear where America was going. It was clear we did not want the new bureaucracy and we did not need the new withholding.

The Treasury and IRS and a couple Members of the Finance Committee and a couple Members of the Ways and Means Committee are blocking the repeal. That is exactly where we are right now, and I think that every time we meet we are developing support, so I am optimistic that we are going to be successful.

Before we begin, I would like to thank the Small Business Administration's Advisory Council and in particular Kurt Charter for being here. Kurt and Bob have organized the witness list, so I would now like to turn the program over to Kurt for a brief comment or two and then if you would like to introduce the first witnesses.

STATEMENT OF KURT CHARTER, DIRECTOR, STATE OF WISCONSIN SMALL BUSINESS ADMINISTRATION

Mr. CHARTER. Thank you, Senator.

You have established for SBA an advocacy role, and we appreciate your coming here to call attention to what we believe is perhaps the paramount issue for this term for small business.

As we have heard as we have gone through this series and will undoubtedly continue to hear, as the business is smaller the impact is greater. Today we have with us eight witnesses, five of whom are here at the moment.

I would like to acknowledge the assistance that has been given to us and to you by our Advisory Council certainly and also the National Federation of Independent Business and the Independent Business Association of Wisconsin and the Wisconsin Association of Manufacturers and Commerce, all of whom have publicized these hearings and in so doing this issue and have thus provided an opportunity for many witnesses and those who are in attendance to be here.

Of the witnesses that we have today, I believe Mr. Gill is occupying the witness chair at the moment, so we will let him go first. Rick Gill is the owner and president of Poly Fab Corp. here in Sheboygan. Rick tells me he has 70 employees.

He will be followed by Mr. Weedman of Vinyl Plastics.

We will let Mr. Gill go first, I guess.

Senator KASTEN. Rick, we welcome you and thank you for your participation.

STATEMENT OF RICK GILL, OWNER AND PRESIDENT, POLY FAB, SHEBOYGAN, WI

Mr. GILL. Thank you. I can see that today is my lucky day.

Thank you, Senator Kasten, for the opportunity to speak to you on this issue. I am not going to claim to be an expert on Section 89. I took some time to sit down with my sister, who is a CPA at our firm, and asked her to explain to me a little bit about Section 89. I will tell you, after 5 minutes I threw my hands up. This is unreal.

I guess the first thing I want to say about Section 89 is, to me, it is a very inefficient tax. To me, part of what Section 89 is is a tax, and it is a very inefficient tax because for every dollar the Government collects, business is going to spend a lot more than that 1 dollar. This is not what we need in the competitive age that we are in today.

We are working very hard to cut costs wherever we can. I guess my feeling is if what they want to do is tax us, they ought to just directly tax us rather than coming up with a new complicated thing that they do not have to call a tax. They can say that there is some other reason for doing it.

Another problem I have with Section 89 is the impact on the small businesses versus the large businesses. For a very large business, if they have a certain number of standard plans, they can win their test fairly easily. For a firm like ours with 70 employees, however, this represents a tremendous amount of paperwork which I think serves no effective purpose.

I think the impact on small business is much greater than that on large business. To me, I think small businesses are very important to America. I am not saying that large businesses are bad, but the American tradition of free enterprise and having a lot of different small businesses really contributes to competition. It contributes to our economic climate in America.

Another issue I want to address is the issue of the whole concept of highly compensated employees. We are in injection molding, and it is a very competitive business. Our unskilled employees make about $7 or $8 an hour for the top rate, which is a fairly good wage.

Our insurance package is not quite as good as some other insurance packages that are in the area offered by some of the larger companies. So we have a lot of people whose spouses work for another employer and they are covered under the other employer's health insurance plan.

The same thing with some of our more highly compensated or more skilled workers. They have insurance under our plan where maybe their spouse does not have insurance where they work.

All of a sudden we are presented with this tax proposal that says there is something wrong if someone is higher compensated and gets more benefit dollars. To me, I do not think that is really fair.

One of the things that my sister was explaining to me is Section 89 goes on the dollars of benefit. Now it costs more for an older employee when you have a health insurance plan than it does for a younger employee. My more highly compensated people tend to be older. As the worker is there longer, we hope that they may learn more about the business, they may actually go back to school, they may raise themselves in the business.

All of a sudden because they are making more for their insurance, Congress is saying that is not fair; we ought to tax that difference. I think the principle is flawed.

So those are the three major objections I have to Section 89.

Thank you.

Senator KASTEN. Rick, thank you.

What I would like to do is put us together in different panels. I will ask Tom to speak now and then address some questions to each of you. Then we will go to the next panel.

So this is Mr. Tom Weedman, director of personnel and public relations of Vinyl Plastics.

Tom, thank you for joining us.

STATEMENT OF TOM WEEDMAN, PERSONNEL/PUBLIC RELATIONS, VINYL PLASTICS, INC., SHEBOYGAN, WI

Mr. WEEDMAN. Thank you, Senator.

I consider Vinyl Plastics a small employer, although we are a little larger than Rick. We have about 300 employees. We have three manufacturing sites here in the State of Wisconsin, and our corporate headquarters are here in Sheboygan.

I am primarily employed to promote the end of good employee relations and sound policies and the effective utilization of our manpower at Vinyl Plastics. Also in my job description there is a sort of subscript that says to comply with all Government reporting requirements, and so forth.

Well, suddenly that little subscript has become the major focus of my employment. My employer, my boss, notes that I spend probably 90 percent of my time trying to comply with some of the regulations that have been passed. In particular, Section 89 is the latest burden we have had to bear.

It is getting to the point where Section 89 has almost become the straw that broke the camel's back with the passage of TEFRA and ERTA and various regulations that have been passed.

In an effort to comply with the Section 89 regulations, I have already gone out and tested our plans and already gone out and tried to get a jump on what we may have to do to comply. Our owners are very concerned about having to go up to particular groups of employees and tell them that their benefits are either going to be taxed, dropped or altered in some way in order for us to comply with the legislation.

So they asked me prior to the legislation becoming effective to go out and run those tests and see what effect it may have on our plans.

So I did go out and did our testing and got all of our results in. I had to employ a consulting firm. I cannot do it myself. I cannot even understand how to do it myself. I would have spent weeks and I did spend weeks at seminars and weeks reading about it. I eventually gave up and said I am going to have to get a consultant to do that.

I went out and spent between $6,000 and $8,000 in consulting fees to have the tests run only to find that we were in full compliance from the standpoint that we were not discriminating in favor of our highly compensated employees except in two minor areas, that being life insurance, which I believe is already regulated pretty heavily under Section 79. Under Section 89, however, we were discriminatory in our life insurance.

At the time we ran these tests, our objective was we were not going to let this add to the tax bill of our employees. If it is going to be a taxable benefit, we would just as soon get rid of it rather than have to go to them and say, sorry, we are going to have to add this to your W-2s.

So after running the test and finding we had certain discriminatory benefits, I went out and notified the people in one case that we were going to leave the benefits because it was a minor, minor tax in the case of life insurance.

I think I agree with Mr. Gill that the amount of dollars spent or generated by this legislation is going to be minuscule, and I think other employers will probably take the same stance of trying to avoid generating tax dollars by taxing their employees further on their benefits.

One other point I would like to make, and I am sure other people share this opinion, is that we do have executives in our company that would be considered highly compensated.

It is our position that a vice president of marketing, for example, certainly may be worth more benefits than a person who may be working in our factory sweeping the floors. The person making the decisions on that level can affect the very job of the person sweeping the floor and may ultimately affect the success of our company. I see nothing wrong with providing that executive with a high level of benefits.

I think, therefore, that is a sound concept, and we would like to continue to do that. In light of Section 89, however, we may not do that. We may simply tell him to go out and buy his own extra perks, and so forth.

So in conclusion I would just simply like to say that I do not believe that this particular legislation is going to generate a great deal of tax revenue for which it was designed. It will simply add to the staffs of our company to have to employ or go out and get consultants to figure out how we are going to comply with this. The result of those decisions I am sure is not going to generate a lot of tax dollars.

Senator KASTEN. Thank you very much.

I would like to comment on this because you both brought up this question. When we began this I did not know how much it was going to cost America, either. You just said your consultant was $6,000 to $8,000, and the lawyers and the accountants and others come in with their meters running as well.

So a number of people went out, and one of the things that is available on the briefing table is a report from the Institute for Research on the economics of taxation. At the top of it is July 24. You can look at this later, but I just want to summarize.

What this says is that the Treasury Department claims that they are going to pick up between $120 and $140 million as a result of Section 89 new taxes. I do not agree with that. If they do, it will be just one time because as Mr. Weedman just pointed out, people are not going to leave their plans out of compliance. They are either going to drop the benefits or adjust for it some other way.

The revenues to the Government do not count the people to be hired at Treasury and IRS in order to read the forms and to go through the test that you are going to be putting together.

I am not saying it is 1 to 1, but even if it is a 10 to 1 or 20 to 1, 1 percent out there of every 20, there is a huge increase in bureaucracy at Treasury and IRS in order to do their half of this, and they are not subtracted from the $120 million revenue estimate which the Treasury and IRS are coming up with.

The more important question is how many of you are here that ate the $6,000 or $8,000 per year? The answer according to this economic survey that was done along with the Chamber, NFIB, small business groups, large business groups and this research on economics and taxation, the cost to America would be $4 billion in accounting fees, legal fees and transaction fees.

So let us just give them their $120 million and say that there are no offsets and we will pay it forever, that we will make no adjustments in our plans and we will keep having $120 million come into the Treasury.

America will be paying $4 billion to get the $120 million in there. That is just crazy.

I am going to ask you this question in a moment, but, more importantly, in our mail and in our hearings yesterday and also today a large number of people, particularly those with 10 employees or less, of which I have no example in front of me now said we cannot afford the legal and accounting costs in order to go through the tests. We therefore will drop our insurance completely.

There is a small phone company in this region that we talked to this morning from Manitowoc that is just going to drop it. It is just not worth it. They cannot afford the accounting and the legal fees.

Yesterday in Green Bay there was another individual that said it was going to cost him between $25,000 and $35,000 per year, and that is close to what he made last year. So if he wants to put Section 89 in, then that takes care of his profit margin for the last year.

Now how many different plans do you have? Do you have a large number of plans, a cafeteria type of system; or do you have one basic plan going across?

Mr. WEEDMAN. It is not a cafeteria system, but we thought we had only about four or five. It turned out to be in the upper teens, as I recall the number of plans, because of the definitions. We ended up going through what is a plan.

Senator KASTEN. If Section 89 as proposed were to go through, would you adjust by dropping some of those plans? Have you made any determination of what you might have to do?

Mr. WEEDMAN. That question has been raised, simplifying and giving one plan for everybody and not messing around. It is not that the 17 plans that we have are necessarily favoring highly compensated employees at all. The purpose is different plant locations and different groups of people.

The thought had crossed our mind for the first time. It sort of scares me as a person who is employed to promote good employee relations that we are sitting around talking about scrapping all of these plans. I am speaking of pension plans also because they are similar, saying why not just go out and give the employee the money and let them worry about where they get their health coverage and where they get their life insurance. Maybe they can find a good deal out there.

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About the only way we can get some PR out of the thing is to continually go to them and say the government has just passed another law, and I am sorry but we are going to have to tax you. It becomes a very demoralizing thing for our employees. They do not understand what is going on, and instead of promoting good employee relations we are left in the role of informing them of the bad news, the doomsayers.

I think we can almost get some PR out of saying, listen, we are going to give everybody a $500 a month raise, and the down side is you are going to have to go get your own insurance and your own whatever else we cancel.

It is scary to me because we are starting to think about that. I do not think that is in the best interest of the employee, but that is a scary thought, and I think more employers are thinking of that now.

Senator KASTEN. Rick Gill, have you given any thought of dropping and cancelling certain kinds of benefit plans, particularly health plans, as you have looked into section 89?

Mr. GILL. Well, Senator, I have not looked into it in the detail that these people have. I am not sure how many plans we have right now, but as a businessman I can tell you that we would simplify it. We would not go with four or 10 or 17, the one example I read in here. We would not go with that many plans. We would simplify it to the point where the paperwork would be minimized.

I guess that concerns me because I think one thing you are taking away from people is choice.

Senator KASTEN. I just wanted to make one other comment with regard to how this impacts on different sizes of business and how it impacts even people who make money in this process.

Randy Olm is an accountant, so I am going to hold the next question until I get to Randy, because what has been interesting is even people who in effect are going to make money by having the Government regulations too complicated, for Tom or for Rick to understand, are coming to us and complaining that this is too much for even them to deal with. It is not just because they have benefit plans within their own legal firms or accounting firms or consulting firms but also because they are so unsure of being able to give business the right kind of advice based on the conflicting and confusing regulations.

So let me just say thank you to both Mr. Gill and Mr. Weedman. Thank you both very, very much for your testimony today.

What I would like to do then is to ask the next two witnesses to come forward, and we will proceed.

Mr. CHARTER. Senator, we will have coming forward Mr. Tom Reilly, personnel director, Wigwam Mills, Inc. in Sheboygan; and Mr. Randy Olm from Schenck and Associates here in Sheboygan.

While they are coming forward I would like to mention that Schenck and Associates, the partners and the personnel, were very much involved in the Governor's Small Business Conference and certainly have gone a long way to earn a well-deserved leadership position as the CPA firm representing the interests of their clients in legislative issues.

Senator KASTEN. Thank you, Kurt.

Why not begin with Mr. Tom Reilly, director of human resources, Wigwam Mills. Tom, welcome.

STATEMENT OF TOM REILLY, DIRECTOR OF HUMAN RESOURCES, WIGWAM MILLS, SHEBOYGAN, WI

Mr. REILLY. Thank you. You summarized my views exactly.

I am speaking as the personnel manager for a small- to medium-size company. Wigwam employs about 400 people, all here in Sheboygan, and I am probably in the worst of all worlds.

Unlike Rick who can claim some ignorance because he is not in the personnel field, I should know about Section 89. But I do not, at least not as well as I should. So I am in the awkward spot of having to try and follow the regulations as best I can for my company, feeling quite inadequate in the process.

I have three problems, really, with Section 89. The first one is I am confused regarding the purpose of it. Second, I have severe problems with its complexity and the cost. Third, I believe it discourages creative alternatives to benefits.

The first one is its purpose. My understanding is that it is supposed to encourage more people to be covered by health insurance. It is my understanding that many large employers who have many part-time people are deciding either not to bother with section 89 and gross up earnings of the highly paid so that they do not have to deal with this issue, or in some cases cut out health insurance altogether.

If they are grossing up wages, what the Government is doing, in effect, is raising taxes. I have to come back to what Rick said. If you want to raise taxes, then just do it but do not do it under this kind of a camouflage.

If you are attempting to cover more people with health insurance, I question how successful you will be. You may be marginally sucessful, but, in my opinion, it is not worth all the effort.

As far as the complexity of it is concerned, benefits are part of my job, but only part of it. Like Tom, I have other areas, too: Labor relations; safety employment; compensation; affirmative action. The list goes on.

This law is complicated. First, there is the law. Then there are the technical corrections to the law. Then there are the explanations of the law and explanations of the technical corrections, and all these come at very inopportune times.

What it boils down to is for someone in a small business who does have the in-house expertise, an exteral resource must be used. We did not even get as far as Tom. We just gave somebody the preliminary data to do the test. That cost us $5,000. Between the time we gave them the data and the time we got our results, the law was put on hold or suspended. So we do not even have a report for our $5,000.

That is not so bad if the law is permanently suspended. But what we have done is to create an industry overnight, an industry to explain this rather complex law. We are adding nonvalue costs to an already very expensive business cost.

In addition, Section 89 is difficult to explain to people. It is especially difficult if you, yourself, do not understand it all that well. It is hard to understand why we are doing all this.

There is one thing I would like to leave you with, I cannot overemphasize the frustration that we have over the complexity and the cost, and the cost to outside consulting firms may be but the tip of the iceberg. The hidden costs are the costs in management time in trying to understand and the time in employee time trying to explain, to say nothing of the ill will and lack of feeling of control over your own destiny that both employer and employees have as a result of something like this.

Finally and perhaps most major, I feel that this law may dampen creative ideas toward providing benefits. It is our feeling that benefits are not benefits unless people perceive them as such. Many people including many part-timers have medical benefits through a spouse. For them, they are working for one reason, and that is money. Requiring their people to have benefits will make them, especially part-time people, more expensive, to such an extent that it may eliminate their positions.

Also, we are providing them benefits that they do not really perceive as such because they have benefits someplace else.

Another concern that I have is that Section 89 may have a dampening effect on the whole idea of cafeteria benefits. This, in my opinion, is an outstanding way for companies to allow their people to select benefits that best meet their individual needs. By being forced to run through a complex series of tests such as this, the end result may be that the whole idea of making your benefits fit peoples' particular needs may become a thing of the past. If this happens, it will be quite unfortunate.

In summary, I feel that due to the supply of labor which will become increasingly scarce, companies will have to offer benefits that attract and retain good people. Benefits are complex enough already to companies who administer them and to the people who consume them. If we have to do anything, let us try to make them more simple, not more complicated.

They are also more expensive than they need be or than they should be. What we do not need now is adding nonvalue costs to an already expensive business expense.

Thank you.

Senator KASTEN. Thank you very much.

Randy Olm.

STATEMENT OF RANDY OLM, SCHENCK AND ASSOCIATES, SHEBOYGAN, WI

Mr. OLM. Senator, I represent the firm of Schenck And Associates, and I am one of those people who is not sure I want all the full employment that may be provided under this law.

The complexities of this law are, I guess, well discussed here today. Being on the side of the fence where I am going to help my clients comply with this law, I am convinced that even with a valid attempt, if a company or the companies of this country are able to get within 75 percent of compliance, we are going to be lucky.

It is getting to the point where the average company is just not going to be able to comply, not because they are unwilling to but because they just cannot understand the law or get the help they need. It just becomes cost prohibitive.

The first thing I think Congress needs to decide is what was the intent of this law. Was the intent to try to broaden the scope of those people who are not covered under health benefits, or was it to raise taxes?

It has been my experience so far that the only thing that is going to be accomplished by this bill is to raise a certain amount of tax. I do not believe that there is going to be any broadening of the health benefits.

As you have indicated, it has been my experience that the small employers are doing what they can to provide health benefits to their employees. They are already under a severe market pressure for employee base. That is well documented in the Sheboygan area where those people who are paying on the lower end of the pay scale and are providing minimal benefits which their businesses can afford are losing employees to the firms that are capable of absorbing those higher benefit costs. I think the market system will work in that regard.

In the statistics that you quoted from the Treasury Department, I would be interested in seeing a summary from them as to how many of those dollars they intend to raise out of the small business sector as opposed to the larger firms.

It is my conclusion based on the preliminary work that I have done that this is really nothing more than the small businessowners' tax. The average business that I serve is a family-owned business, typically an individual who has a skill of some sort or an expertise. Typically, he is working very closely with his people. He has his shirt sleeves rolled up, and his hands are dirty. In a lot of cases, we have second generations becoming involved in the business. When you run the test for that average small business where the typical scenario is three or four family members employed in the business, five or six employees that are currently full time being covered under the plan in some way or another, and two or three part-time people who we need to get certain jobs accomplished but really cannot afford full time or the business has not grown to that stage at this point in time, that client is going to fail for several reasons. I want to talk about one specific here shortly.

They are probably going to fail that test strictly because on a percentage basis their base is so small that one or two people who do not fall into the right classification will throw them out of the water.

He now has two options. One is to pick up all those part-time people, which is cost prohibitive. His business just will not withstand the extra $300 per person that the average health benefit is covering.

So his option is to gross up his income, to bite the bullet, say I am not going to comply with Section 89, I will just pay tax on my health insurance benefit. In effect, he has just decided he is willing to pay you the tax instead of trying to mess with the complexities. As a result, this becomes a small businessowner's tax in my judgment.

One of the technical problems that I see in this law that if Congress in its wisdom does not decide to repeal at least needs to deal with is the area of who is considered covered and who is not.

As all of the other previous testifiers have talked about, it is the part-time person who is covered under a spouse's plan. That is very common in our local economy. It is my understanding of the law that you can exclude those part-time people or those people who are covered under a spouse's plan if those people are willing to sign a statement to that effect.

The other piece to that is that you can only exclude those people if they have an unlimited ability to come back into your plan without proving insurability at the point in time they choose to come back. That is not available in the real world today.

The clients that I serve are typically the small groups. They are having a very difficult time getting insurance for their people anyway. Because of their small group status, they are struggling to get that insurance.

Senator KASTEN. The rates are going through the roof.

Mr. OLM. The rates are going through the roof, so that just compounds the problem.

As a result, unless Congress legislates that all insurance policies will in fact have unlimited entry which the insurance industry then has to deal with, I do not think my small business people can comply if they want to because, as these other gentlemen have stated, most clients have one or two spouses where the employee spouse is working most notably here in the area at the Kohler Company.

The Kohler Company's plan is a good plan. They have struggled with their costs as well, and it is well documented that they have done some things to their plan, but it is still kind of the Cadillac of the area; therefore, employees will typically take that plan over anything my small business employees can even lay their hands on.

As a result, my client now has the problem where he cannot exclude that person from his computations because his plan will not allow for the unlimited recall and we fail the test without even trying.

I guess my conclusion to this is that Congress has to recognize that we are currently functioning in a world economy. Even in Sheboygan, as remote as we might feel we are sometimes in a true world economy, we are functioning in that economy. We have to stay competitive. That is well documented.

The amount of overhead, therefore, that people are able to afford is dictated by that world economy. We would all do what we could for our employees based on the market supply and demand that this country was based on, the free market system. We will do what we can within those parameters, but we have to stay competitive.

It is my statement that Congress has to let the free market system work; therefore, we have to repeal Section 89 because it makes no sense in that free market enterprise.

Senator KASTEN. Randy, thank you very much.

Before we begin with questions I would like to respond to two points that were raised of what actually took place: First of all, the

question about what the purpose is; and second, this kind of changing status that you referred to in terms of where do we stand.

First of all, when we began this whole process of so-called tax reform and tax simplification, if you remember it was Bradley-Gephardt on one side and Jack Kemp and I on the other. We had Kemp-Kasten and Bradley-Gephardt, and then we got Packwood and Rostenkowski, and then we started mixing with Secretary of the Treasury Baker. The whole thing started mixing, and we have gone a long way.

The way this part of the tax bill began, first of all it was not a subject of major debate either with Kemp-Kasten or Bradley-Gephardt or Packwood-Rostenkowski. We were all worried about the rates, whether we would have a differential for capital gains, wether we would be able to keep IRA's, some of those issues.

Some people on the majority side of the Ways and Means Committee came up with the idea that all benefits should be taxed. This began as a tax increase, the purpose of which was to raise revenues. They believed that all benefits should be taxed to all people, particularly the staff group came out supported by two or three of the members of the Ways and Means Committee.

That meant the health plans should be taxed to everyone. That meant the trip the stewardess on Midwest Express gets for her sister or for herself if she is going on vacation should be taxed. That meant that the tie that I would buy if I was an employee of Prange's and I get 20 percent off because I work there would be taxed.

Any benefit they believed should be taxed, and what they were trying to do was increase taxes. That is the way this began.

In the end, the compromise position was, listen, we do not want to go through all the trouble of taxing all these different people. This is not what we in America want to be. Just think of how difficult it would be to go through the reporting. It is not worth the money. This is simply not worth the trouble.

In the very end, the minority again of the committee raised the question, well what about all these people who have these huge fancy plans and others who have none? Let us tax them at least. They worked it out, saying if there is a way to do that, fine, let it go, without ever knowing there were any groups of highly compensated employees not compensating themselves in terms of benefit plans in roughly the same way.

There were a couple of life insurance questions that were brought up here earlier, but there was not a problem. They did not know of a problem. It began by people wanting to tax all benefits, and they lost on that. They fell back to this, assuming that there is some kind of inequity out there that in fact is not here. Your clients do not have plans which are discriminating. It is not there.

So the history of it is, it began with people wanting to raise taxes and tax benefits to all people because they believe in increasing taxes. That is how it began, and this is how it has ended up.

Now we have the situation where all the people who were proponents have said that is not what we really meant, and no one in Washington is saying that we want Section 89 as it was. That is partly because we have been successful in pushing these votes. Everyone is running from it, including Packwood, Bentsen, and Ros-

tenkowski. They are all saying this is not what we meant, but we can fix it, we do not have to repeal it.

This is the issue really before us now. Just for the purpose of history, that is how it started. They wanted to tax all benefits to all people under all circumstances.

The status of the bill was supposed to be effective January 1, 1989. It became clear in March and April when they had not published the regulations and then in May and June when they were publishing so-called technical corrections and had not published the regulations with those corrections that it was going to be close to impossible to go back retroactively to January when no one even knew exactly what kind of reporting was going to be required or how these tests would be administered.

At that point we had a couple of debates in the Senate, and because of what took place in the Senate, Secretary of the Treasury Nick Brady made an announcement that there would be no enforcement and no Section 89 before October 1, 1989. So it is not effective now and will not be retroactive. It will start in October.

Since then, in the last 2 weeks as this whole Section 89 effort has increased, we have been successful, I in the Senate and someone else in the House of Representatives, in putting into the bill which appropriates money for the Treasury Department a prohibition on using any of the money that we are giving the IRS and Treasury for the purpose of enforcing Section 89.

Now that means that they cannot enforce it, and the reason we had to do that is neither the Finance Committee nor the Ways and Means Committee will let votes occur on the floor. They have it blocked procedurally. So we just did it in the appropriations bill. We took their money away.

Now the good news is it has effectively repealed section 89 for the next fiscal year, so that will be the year that begins this October and will end next September 1990. So nothing is going to happen between now and September 1990.

The difficulty is that the appropriations bill only goes for a year. We cannot repeal it outright, but we are hoping that this is the beginning of repeal. Rostenkowski has not been successful in restoring the money in the House, and Bentsen has not been successful in restoring the money for the Treasury in the Senate. That just shows they know they do not have the votes. It is just that they were not allowing us to vote.

So it is not unlike the situation we had with 10 percent withholding in interest and dividends. It took us about 9 months to finally get rid of that. I think we will be successful this fall in getting rid of Section 89. That is my hope.

Tom, I want to go back to the question about whether or not you or your company have considered dropping all of your plans. Now, I know that is scary to think of as a personnel person. You do not want to be on record saying our company wants to get rid of its benefit plans, but I am trying to make the record that a large number of people thought they couldn't go through the cost and the possible penalties would drop or alter some of their plans.

Are you far enough along to know whether you would consider doing that?

Mr. REILLY. Our thinking is no. We have one health insurance plan for everyone, and so we are a lot like Tom, where after we go through the effort of doing the test we expect to comply, but we have to go through the test to show that we have complied.

So no, we have not thought of dropping our health insurance plans.

Senator KASTEN. Randy, of the clients you have talked to, you have mentioned the fact that some of these smaller ones are going to find themselves jammed and increasing their own salary and somehow be covered under some other kind of a group.

Is this typical? Is it the rule? Is it the exception? Generally speaking, what do you find in terms of how small businesses might deal with this?

Mr. OLM. Well, No. 1 is in the real small group where you may have an owner and two or three other employees, it does not take anyone too long to figure out that if you spend too much money doing any kind of computation at all you are better off just cancelling the plan and forgetting about all the complexities.

In the typical client, I would say 10 to 30 people, they may take one runthrough to see if they can get anywhere near compliance. The likelihood is that they will not, strictly because the base is too small and you end up with the technicalities that I think are going to ruin their test.

Then it becomes an economic decision. What is our cost going to be to cover the people we need to comply versus the alternatives? On those that I have been able to work with so far, the easy answer is step one, the ownership group or the highly compensated group, which in my case is typically the owner group, maybe we have one other employee who hits the $45,000 or $55,000 levels that are in the law, but I guess most of my owners wish they were hitting those kinds of levels to start with. They are defined as highly compensated because of their ownership.

It is a matter of figuring out what the tax on those dollars is going to be relative to what the cost of complying would be. At the point in time where the ownership group is going to pay the tax on the benefits, then there is no incentive for them to continue to provide benefits to their employees other than the control of the free market system; what do we need to do to keep employees. There is a point in time where they can easily be dropped.

Again, most of my smaller clients are struggling to keep their insurance in any kind of a reasonable or affordable range so that they can actually keep their policies in place the way it is.

Costs are just going through the roof on these small groups. I do not see where this law is going to generate any additional coverage to any additional groups. The free market system is going to do that if it can be done. The only thing Congress could do in my judgment is to pass the investment tax credit of health insurance, provide a tax incentive to get people to include more people on their health plans.

This is not going to do it. This is just strictly, in my mind, a revenue raising procedure.

Senator KASTEN. Well, I think it clearly is a disincentive also and, as you pointed out, the national study that I referred to before also said 20 percent of the people would either drop or lessen the

coverage; either would drop their plans completely or lessen the coverage.

So you have roughly a fifth of people in this country who will drop their coverage or would lessen it, and I think that that makes the point.

Let me thank you both.

At this point in the record we have testimony from a number of people and also some letters from a broad spectrum of people from this community all the way from a bowling lane through machinery companies through a dental center and a savings association. I would like to ask that the letters and testimony of these people be included in the record at this time.[1]

Although we do not have representatives of the local government or the county government, we did have in Green Bay representatives from the Brown County government testifying, and we also have the Brown County school administrator testifying.

The fact is that the problems here we are talking about with regard to section 89 affect local government, affect county government, affect school boards, affect school systems and the school administration. Also in Manitowoc we had the City Attorney.

So this is not an issue that is only a small business issue, although this is only a small business hearing, but it is important to point out that this is affecting all the way through society.

First of all, thank you both very much for your testimony.

My understanding, Kurt, is that we have one further witness; is that correct?

Mr. CHARTER. Senator, we have one remaining scheduled witness. Jackie Beaudry is here representing Vollrath Company. They have prepared testimony, and I believe she would like to offer a brief summary and ask that the prepared testimony be entered into the record.

Senator KASTEN. Great.

Jackie, we thank you very much for joining us and going over the statement.

STATEMENT OF JACKIE BEAUDRY, VICE PRESIDENT OF HUMAN RESOURCES, VOLLRATH CO., SHEBOYGAN, WI

Ms. BEAUDRY. Thank you, Senator.

I am vice president of human resources of the Vollrath Co. here in Sheboygan. So much has been said that I do not want to repeat already a lot of the same feelings that we have.

Last fall in an effort to comply we hired a firm in order to assist us in preparing the testing to make sure we are in compliance with Section 89. We paid to the tune of $7,000. Somebody else got a deal. I need to find out where he went.

This was only to find out again just about the time we were finished with the testing that it really was to no avail because everything was on hold and we are probably going to have to do it again.

By the way, we complied with what we thought was the law at the time.

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[1] Material referred to appears in appendix.

At our company we have the same benefits across the board. We do have cafeteria plans for many of our employees, the salaried employees. For that reason, it was very complex in order to come into compliance with the law.

Fortunately or unfortunately, we have no intentions at all of changing our plans because of it. In fact, right now we are taxing for some of our highly compensated individuals their life insurance. That is really the only area where we had any discrepancy.

Because of this, we found additional work, additional paperwork. Frankly, we are supposed to be about the business of keeping our 550 people employed and keeping us competitive so we can continue to do those jobs in the community and create more jobs and can't be concentrating on compliance and on more Government regulations that add no benefits to our employees or the community.

It is the only one that we see as benefitting the few tax dollars we are paying and the consultant who got our money. Otherwise, we really have made no one richer. We wanted to go on record to say that.

We really encourage the repeal. We appreciate the information that we received today regarding the actions that have been taken in Congress.

Thank you.

Senator KASTEN. Jackie, we thank you. Your full statement will be made part of the record.

I just want to point two things out. No. 1, we have ended up with some businesses testifying here today that once were small businesses and now are successful and have become larger businesses.

The number of businesses in Wisconsin that are 20 employees or less are in the neighborhood of 80 percent. So when we start talking about 100 or more, in this case 200, 300 and 400, we have a lot of larger businesses represented here at least in the overall scheme of things.

The point of the hearings is to really talk about that group of 20 employees or less or even 10 employees or less because that is where the pinch really comes. They are the ones who are struggling as Randy importantly pointed out.

That is where the important decisions are, and this is where the jobs are and why we have 2 or 3 or 4 percent unemployment in this community, because a lot of those five- and six-people businesses are now 10 or 12. That is the progress we are making in Wisconsin.

The damaging effect that Section 89 would have on jobs and the kind of economy that we have in our State I think just cannot be overestimated because it is that new group, that small group, the individual who just went out there to take the chance within the last 1 or 2 years, that man or woman is the one who is unable to have the personnel departments and others that some larger companies have. Of course, everybody hopes someday they will be as successful as a number of the businesses that we have here.

The other statement that I want to make is we, overall in America ought to have a policy and incentives in the system so more of our population will be covered by private health insurance so less of our population will be dependent upon Government assistance and Medicare.

If anything, you have to have incentives in the system to help with insurance. This is clearly a disincentive. The real question is how much of a disincentive is it, and it is clear for different people it is more or less.

We in America and in Washington an awful lot of this administration are talking about how important it is that we have health care coverage in the private sector, we do not want to go to national health insurance or the English system. We want to have the private system do it. Then we come along with Section 89 which makes it harder for the private sector to do what we say we want it to do.

So there is just a direct contradiction. Unfortunately, that contradiction is not as strong in the Senate Small Business Committee meeting room in Washington as it is in Green Bay, Appleton, Manitowoc, or Sheboygan.

I therefore want to thank all of out witnesses very much for their testimony here today.

There is a brief opportunity if there are one or two people in the audience who would like to make a very brief statement with regard to something that has not been said. If you would just raise your hand. There are three.

Why not come up here, and it would be better to introduce yourselves with your name and your company.

STATEMENT OF DAN WEIGEL, CORPORATE DIRECTOR, SCHULTZ SAV-O STORES, SHEBOYGAN, WI

Senator, thank you. My name is Dan Weigel. I am the corporate director of human resources for Schultz Sav-O Stores here in town. On behalf of our company, and I suppose most of the people who are aware of your fine efforts both at repeal of Section 89 and certainly your efforts to delay its implementation until further thought has been placed on this, I think we understand the rationale, the reasoning behind the legislation.

If employers are going to get tax breaks for providing benefits, then they should be provided on a nondiscriminatory basis. I think we have heard the testimony of how to do that.

One other thing that is not perhaps associated with Section 89 but has to do with employee benefits is what we are seeing happen in some of the committees of Congress today, which would suggest another revenue-generating idea. On behalf of our company and perhaps all business, we would hope you become involved in that, too, to make sure that proposed legislation never does become law. That is the attempt to charge filing fees for mandatory 5500 financial employee benefits reports that most employers are required to provide to the IRS every year on the status of their plans.

Between that issue and Section 89, I guess the only thing I want to say personally on behalf of our firm and others, is continued good effort and good success, and we hope ultimately Section 89 will be repealed or substantially changed from the way it exists today.

Thank you.

Senator KASTEN. Thank you very much.

I think it is fair to say that, frankly, it is up to you. The Congress is going to respond if America gets upset enough, and we are now at that critical spot. I think we are going to be successful, and we need your continued pressure. I appreciate very much your being here at this hearing.

If you could introduce yourself.

STATEMENT OF PETER MAYER, ROHDE, NEUSES & DALES, SHEBOYGAN, WI

Mr. MAYER. Yes, Senator. My name is Peter Mayer. I am an attorney with the law firm of Rohde, Neuses & Dales, Sheboygan, and our firm represents mostly small businesses but also some large ones.

First I would like to state that our law firm does profit from Section 89. However, we feel that we need to object to it and raise some concerns to Section 89 and also to H.R. 1864 and S. 1129 in which the intent is to simplify Section 89.

Our experience is that employers have been considering withdrawing employee benefit plans rather than face the testing, reporting and penalty provisions of Section 89.

We have experienced some employers who are considering doing that and are merely waiting for the effective date of Section 89 before they carry out those plans.

We have also experienced some employers who are ignoring the rules, including Section 89(k) rules with an attitude that resembles whistling in the dark. They are hoping it will just go away. Hopefully it will, but if it does not I think their plan is to wait until Section 89 is enforced on them specifically.

Obviously as attorneys we cannot accept that sort of decision, and we advise strongly against it. However, the businesses have a strong reluctance to employ the services of legal counsel and accounting firms to test the plans because it is a great cost to them.

The main problem we see with Section 89 is complexity, the complexity of the testing requirements, the data collecting and reporting requirements and the numerous changes in the law over a short period of time, within a short time before the law was intended to be enforced.

Another concern lies with the ignorance of the ways that the law would be applied. I have personally had some conversations with the IRS, and I have discovered that there are some individuals at the IRS who are less informed than I as to the way that the provisions of Section 89 will be carried out.

Senator KASTEN. If you can believe it, they sent a person to testify to the Small Business Committee at our opening hearing on Section 89. Maybe they picked him so that he would not know much about it, but they sent a person who had just come into the Section 89 part, and he was able to answer most questions by saying I do not understand that, I am new.

We got through I do not know how long, and we asked for a new witness from the IRS. We got one. But you are right.

Mr. MAYER. Our recommendation would be a position that you are comfortable with, which is the complete repeal of Section 89. If

that is not possible, though, we would like to see a delay in the effective date until 1 year after regulations are issued.

I do not mean to undermine your position on H.R. 2989, the appropriation bill, at all. We appreciate that. If the law is going to become effective, however, it would be very helpful to have at least a 1-year delay between the time that regulations are issued and the enforcement is going to occur.

Also, I would recommend an increase in the number of employees in the test for small employers. As the testimony has been presented, there are many individual companies here that feel that they are small employers and they do not meet the 20 employee tests of H.R. 1864.

We feel that there are quite a few employers who could consider themselves small employers even though they do not meet that test. Therefore, we would ask that that number be expanded; to what number, I am not sure.

There are employers here who I have heard say that they have 300 employees and consider themselves small companies, and I think that is probably true.

I think it is necessary in order for businesses, that are our clients, to compete in the world economy to have that advantage which can only be gained by the repeal of Section 89.

Thank you.

Senator KASTEN. Peter, thank you very much.

I think another area that Randy touched on is this idea of a highly compensated employee being highly compensated, one because he owns more than a certain percentage of the business.

You and I could start a fruit stand this afternoon, and our income for the whole year might be $2,000 or $3,000 and we would split it, but we would be defined as highly compensated employees because we own the business.

Again, if you start thinking about that person right now, maybe he is in a big city. Maybe he is a Korean immigrant and he is going to take a chance and start something small on his own. Maybe it would be a food stand.

That person all of a sudden becomes a highly compensated employee without any regard to how much money he or she wants to earn. It is just against what we as the United States of America, I believe, should stand for.

Thank you for your testimony.

One more individual. Could you introduce yourself and the company you represent?

STATEMENT OF LYLE WATSON, PRESIDENT, WATSON VENDING SERVICE, SHEBOYGAN, WI

Mr. WATSON. Thank you, Senator. I am Lyle Watson. I am president of Watson Vending Service based here in Sheboygan. I also was a coordinator for the governor's conference on small business representing Sheboygan, Ozaukee, and Manitowoc Counties. I also was a representative to the White House Conference on Small Business from the State of Wisconsin which was held in 1987.

Most of the things that were mentioned this afternoon I do not want to become redundant on. However, one fact that I think we

maybe all forgot to mention is that, indeed, it is inflationary. Somewhere, somebody is going to pay for this thing somehow.

I represent small business. You alluded to the fact that most businesses in the State of Wisconsin, approximately 80 percent, are less than 20 people. That is a fact that is nationwide, so it is not only in the State of Wisconsin.

Most small businesses do not compete with the larger firms paying the higher salaries. They may come close but they do not compete.

In my type of business I have a mix of half full-time and half part-time employees. I am in the food catering business. I compete on that level where my salaries are on the lower scale. When we do a catering job, for instance when I can do a Friday and Saturday catering job, it is very conceivable that we can put in long hours for 2 days, let us say 20 hours.

According to Senator Kennedy, he is saying 17.5 hours will constitute a person that should receive full benefits. If, indeed, this person is making say $5 an hour working 20 hours, he earns maybe $100 for the week. His medical compensation would be, if I equated it correctly at $300 per month, something close to $70 per week.

This is almost unbelievable to try to compensate as much on medical benefits under Section 89 as it would be for his full salary. This is something that a small business—and I am talking very small—cannot afford.

I am speaking for small business, and I would request that you repeal and keep going at it, and thank you very much for your time.

Senator KASTEN. Mr. Watson, thank you very much.

Are there other individuals who desire to make a comment? If not, I want to thank everyone once more. We have had a number of great hearings. This is clearly one of our most successful.

I thank you for the turnout. This is a wonderful community. I particularly want to thank your mayor for his help and his hospitality and his coffee and disrupting the whole floor here.

Dick, thank you very much for your hosting this successful hearing.

The hearing is now concluded.

[Whereupon, at 3:22 p.m., the hearing was recessed.]

THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE ON SMALL BUSINESS

WEDNESDAY, AUGUST 16, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Eau Claire, WI.

The Committee met, pursuant to notice, at 10:10 a.m. in the Federal Building, 500 Barstow, room 20, Eau Claire, WI, Hon. Robert W. Kasten, Jr. (Acting Chairman) presiding.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. I will officially call the hearing to order and convene a special hearing of the Senate Small Business Committee to assess the regulatory employment and health coverage impact of Section 89 of the Internal Revenue Code. This is a complex, complicated provision, and the whole idea behind what we are doing is to determine the impact of Section 89 on small and growing businesses in Wisconsin.

Today's hearing is part of a series which is being held in Wisconsin. We have had hearings so far in Green Bay, Appleton, Manitowoc, and Sheboygan. This afternoon we are going to be in La Crosse and tomorrow in Madison and Milwaukee, in each case learning from people in the business community and small businesses particularly the impact of Section 89.

Where we can, we are also asking for local officials to testify because Section 89 is not a regulatory burden that will fall only on small businesses. It also will affect municipalities, county governments and, importantly, school associations.

Two days ago, for example, the Brown County school administrator testified about the difficult problem they were going to have with Section 89.

With that, let me introduce our first witness, or at least my first witness, Jim Carter, a friend.

Kurt, did you want to say something about what has taken place before I got here? Then we will catch up and go ahead with Jim Carter.

STATEMENT OF KURT CHARTER, DIRECTOR, STATE OF WISCONSIN SMALL BUSINESS ADMINISTRATION

Mr. CHARTER. Senator, Jim was just beginning. Perhaps he should start over and restate his name and business for the record.

We have a series of at least seven witnesses. Most of those who are here have indicated a willingness to offer comments and have an interest in the issue, so we will go along with that as time permits.

Senator KASTEN. Jim, go ahead with your testimony. Again, I apologize for interrupting you.

STATEMENT OF JIM CARTER, CARTER MANAGEMENT CO., EAU CLAIRE, WI

Mr. CARTER. No problem. Welcome to Eau Claire, Senator. My name is Jim Carter, and I have a small management company that operates three automobile dealerships, one in Eau Claire, one in Chippewa Falls and one in Wausau. I also represent the Greater Eau Claire Chamber of Commerce Legislative Committee which has already taken a position of favoring reform of Section 89.

Section 89 mandates that we evaluate our accident and health plans and our group life plans using a series of overly complex calculations to test for potential discrimination in favor of highly compensated employees.

In addition, Section 89 also requires us, being employers, to review all nonretirement benefit plans which our workers are provided with, tax favored benefits, that is, cafeteria plans which we have in all of our dealerships.

These benefits are tested for compliance with basic requirements related to plan communications, enforceability, exclusiveness, and permanence. These are referred to as qualification requirements, and we will have to produce written documents that verify compliance with these requirements. Failure to do this will result in all of our employees having to report the full value of the benefits they receive as additional taxable income.

Because I have a controlled group type of business, Section 89 requires me to combine all of our different entities when testing for the compliance. That means we have to go to all of our different dealerships in different locations and gather up our staffs to put together and compile all data.

The benefit packages that we have will have to be proven to be the same or at least very similar for each of our businesses whether or not we have designed them that way and whether or not it makes economic sense for us to do it that way.

One of the purposes of Section 89 is to provide more equitable distribution of benefits to employees. In our case this will not and has not occurred. The so-called highly compensated employees is defined by the IRS as somebody that owns 5 percent or more of a company no matter how much they are making.

In our company, the people in the position of highly compensated employees will just pay the additional taxes on the benefits, and the other employees probably will receive no extended benefits at all.

In my view I see a lot of problems coming with Section 89. We will need to spend more money to have outside help to meet the requirements under Section 89.

Among some of the things I see us having to do would be attend seminars just to learn about Section 89.

We may have to purchase do-it-yourself workbooks.

We may have to purchase discrimination testing software.

We may have to purchase Section 89 discrimination testing services to help us.

We may have to spend and already have spent a lot more money with our accounting firm, which is good for their business but costs me money.

We may very well have to employ a benefits consulting firm.

We may and probably will have to spend time and certainly money with your insurance agents regarding their compliance services.

We very well may have to consider a third-party administrator to provide testing services for us.

We may have to spend more time analyzing and evaluating the software vendors that provide the software which we may need.

We will need to spend more time and money discussing the ramifications of Section 89 with our legal counsel.

In conclusion, Section 89 is far too complex and is confusing. It will cost us and our companies a lot more time, money and effort to figure out, first, how to comply, and then the financial penalties if we do not comply are awfully severe.

Obviously, I support the reform of Section 89. I do not think it is necessary, and I do not think it is reasonable.

Thank you.

Senator KASTEN. Jim, thank you very much.

If I may, let me just touch on a couple of points you made and then ask you to clarify.

First of all, Section 89 is a tax increase. It is a tax increase that is going to fall primarily on small businesses because small businesses are not going to be able to get all of their different plans in place as some of the larger corporations are going to do. They already have the big computers. They have everything organized. They can just program their computer. It is going to be difficult for them.

The small business is going to have to go out, as you said, and hire lawyers, accountants and other kinds of groups. You do not have a whole lot of legal expertise nor benefit expertise in your small business. Most small businesses, frankly, are even smaller than yours.

This particular Section 89, of the tax bill, we have tried to put a dollar figure on how much it is going to cost America. The IRS says that they are going to take in roughly $120 million. I disagree with that estimate because people are going to fix their plans or drop their plans rather than pay taxes on them. Maybe the first year they will get $120 million.

Importantly, that $120 million which the IRS says they are going to get is not offset right now by the additional personnel Washington is going to need in order to enforce their end of this. So there are going to be more bureaucrats hired and more problems in Washington and more costs; but let us just give them that $120 million.

We did a study, and the study is included in part of the papers which have been handed out. It was a study that was done by a group called RIET. That is the Institute for Research on the Eco-

nomics of Taxation. The study was put together by this economics group in order to determine how much it was going to cost America to comply.

The answer is before you in the July 24, 1989 summary of the RIET briefing. It says it is going to cost $4 billion in accounting fees, legal fees, and transaction fees throughout America in order to get the $120 million, which I believe is suspect anyway.

So the cost to America is going to be $4 billion in consultant, legal, and accounting fees, just as you said.

Now this is the question I want to ask you. Are the large number of people, particularly businesses that employ 20 or less people, going to look at this and say my legal and/or accounting fees are going to be between $30,000 and $45,000 in order to comply with this. I might not even comply perfectly even then and there may be a penalty, and I cannot afford to continue to pay health benefits to my employees, I therefore will drop my benefit plan completely?

That is an issue that is a very real one, particularly for people with 20 and maybe even 10 employees or less.

We have a letter here from a person actually in Eau Claire saying, "I was considering offering a group plan, but if this bill is passed I won't. For now, I'm going to wait and see." Here is someone who is about to put in a benefit plan, and they are going to wait and see because they do not want to put in a benefit plan if Section 89 is to take place.

Have you heard in talking with your colleagues on the Eau Claire Chamber Legislative Committee or have you in working with your accountants and benefit consultants if people are talking about the possibility of having to discontinue certain kinds of health coverage plans?

Mr. CARTER. Absolutely. Maybe by itself it would not be limiting, but as you are aware, having been involved with it in the last couple of years, the rising costs of small business with other costs for benefit packages—let us just take insurance alone. Because there has been no tort reform, what it has cost us for liability insurance, in our case garagekeepers, health benefits for employees, unemployment compensation, dental plans, all of these things combined, and then putting the Section 89 situation on top of it, for many small business owners it may be more than the straw that broke the camel's back. It is just the final blow.

I have heard a lot of people say exactly what you are referring to, that they just cannot afford to keep doing that. So it is just one more thing on top of the rest that we cannot afford to do.

Senator KASTEN. What you said is important, and in all the testimony thus far we have received a lot of information relating to the fact that people might have to drop their plan.

As some of you may have read, the past week I spent in northern and western Wisconsin working on rural hospitals, because whether it is Grantsburg or Shell Lake or Park Falls there are some real problems in health care.

What troubles me is that people were uninsured and underinsured and could not pick up the insurance.

Our policy at the Federal Government level should be to encourage more people to be covered by health insurance and benefit plans. Here, Section 89 is going directly in opposition to that. It is a

Government policy which is a disincentive for people to provide health insurance plans for their employees.

So it is absolutely contrary, I think, in terms of our overall national social goal of more people being covered by health insurance to have something like Section 89 take place which, according to studies we have done, might force close to 20 percent of the people who now provide health care insurance and benefits to drop their plans. According to the surveys, close to 20 percent of the people might fall into the group to which you just referred.

This is upsetting, especially after what I went through last week in seeing so much that had to be picked up by Medicare and other kinds of programs because they did not have adequate private health insurance and here we are with a disincentive to companies in the Eau Claire area and throughout Wisconsin.

Mr. CARTER. It has a ripple effect, Senator, because what Medicare and Medicaid do not pick up, then it causes the hospitals to charge more money. Who will absorb that? The small business owner who has to pay higher premiums on his insurance. So it gets right back to us again.

Senator KASTEN. Absolutely.

I know we have a number of other witnesses, and I know that everybody's schedule has been confused this morning.

So Jim, thank you very much for being here on behalf of yourself and also the chamber. We appreciate your testimony very much.

Kurt, maybe we can establish a couple of panels here if that would work out. Does that work out with you? Do it whichever way you like.

Mr. CHARTER. Senator, we can have Dave Nelson from Dave's Foods in Glenwood City; and also Lois Krause, who is a partner with the firm of Wipler, Ullrich & Bertelson, a CPA firm. If we could get them up here together.

Senator KASTEN. I want to say, Lois, at the outset that your testimony is probably as important or more important than many of the other people that we have had a chance to talk with because you find yourself in the position of being able to make money on regulations as we make them more and more complex.

Most people in small business are not winners when we come out with complex, contradictory law. Consulting firms, accountants and lawyers in effect make money off of our red tape.

Section 89 has been interesting because even those people who are likely to make money off of Section 89 have been coming to Washington and now have been willing to appear at our field hearings in Wisconsin to talk about the difficulties and the complex nature.

You come at it from two ways. No. 1, you are going to have benefit programs with your own accounting firm. Second, you also have the opportunity to be working with others. We appreciate your testimony.

Let us begin with Dave Nelson from Dave's Foods.

STATEMENT OF DAVE NELSON, DAVE'S FOODS, GLENWOOD CITY, WI

Mr. NELSON. I just have a few short comments.

I own a retail grocery store, and I have been in business about 1½ years. I feel that Section 89 would be a real burden on a small business in a community the size of ours, which is 800 people.

Just figuring this morning on the way here, I feel that Section 89 would require a lot of small businesses to eliminate most of their part-time employees and go to more full-time employees. In a one-block area of our town of 800 people, there are approximately 30 part-time employees, and I would guess that at least one-third to one-half of those would lose their jobs because of Section 89.

Senator KASTEN. Let us go now to Lois. Then what I would like to do is to try to get you both to respond to questions.

Lois, go ahead with your testimony.

STATEMENT OF LOIS KRAUSE, WIPLER, ULLRICH & BERTELSON, CPA

Ms. KRAUSE. My name is Lois Krause. I am a partner with the CPA firm of Wipler, Ullrich & Bertelson, CPA. I am here to testify both as an owner of a small business and also as a consultant.

As Senator Kasten indicated, I have worked with a number of businesses, and I was planning to spend my summer involved with doing some Section 89 consultation. Because of the uncertainty of the nature, however, we are not doing too much in this area.

I have worked in the past year with approximately 100 companies in teaching them, helping them to understand Section 89 and in some cases doing some preliminary testing to some degree.

Because of this complexity of this law, most small businesses do not understand Section 89. They might have been going to seminars. They might have spent already a great deal of time trying to analyze Section 89, and even after spending 8 to 16 hours looking at it they still come back with misconceptions about what Section 89 means to their particular company. So they are looking to the consultants to provide guidance.

This in turn makes it very expensive to comply with Section 89. We are not talking about expensive in terms of providing more benefits to the employee but, again, in terms of professional fees to cover all bases. Most employers, most companies, expect to derive little benefit from this cost.

My experience has been that the result has not been to increase benefits to the general employees out there. Rather, the companies are looking at other avenues to comply with this law.

This means that they are either curtailing their benefits to some of their key employees by finding the lowest possible benefit they can give their employees to make the comparability standards work or they are looking at terminating their benefit package totally.

Many of the small businesses that I work with, those having less than 20 employees, have offered very flexible benefit packages in the past, sometimes reimbursing an employee for their insurance that they might be receiving through another employer, through their spouse; maybe they have someone who is retired and they are reimbursing that employee for their Medicare cost of their insurance.

This allows them to maintain that small percentage of profit that they need to keep their doors open. Because of this flexible benefit package that they have been offering their employees, this will not allow them to conform with the limited test that Section 89 provides to the employers; therefore, they cannot continue offering those kind of benefits.

I have also seen where larger firms who do not discriminate but offer a variety of health packages to their employees so that it does allow the employees to kind of pick and choose the benefits they like know they do not discriminate but still must conform to the documentation requirements because of the discrimination test. This can cost them thousands of dollars on an annual basis.

I have one large employer that I have worked with in the city that was estimating that they were going to spend $7,000 in the first year to get the system up and running, and it would thereafter cost them approximately $2,000 to continue to do this testing on an annual basis. In this particular situation it was a public employer, and this cost would in turn be passed on to the taxpayers through property taxes.

It has been difficult to comply with Section 89 not only because of the complexity but also because of the way we have been receiving the information on a piecemeal basis. We could start doing discrimination testing, but we could not always insure that our clients were covered under the qualification standards, since guidelines had not been issued. This in turn increases the cost to the taxpayer, again with no added benefits.

The penalties for noncompliance for qualification are too large. Whether it is an employee tax as it originally started out or is an employer tax as it has been proposed, qualification is something that is not that important to have those kind of penalties.

Finally, regulation of this area could result in what has happened in the qualified retirement plan area. Because of the cost of compliance on an annual basis, I have seen many companies who have just discontinued the retirement plan benefits to their employees, and I see that as happening in the health insurance benefit area also.

Thank you.

Senator KASTEN. Lois, thank you.

I think this is probably the most important single issue that is involved here; that is, the public policy of the United States of America as opposed to the practical application of Section 89 at a small business, particularly a business of your size.

People who now have benefits are going to find that the benefits have been taken away from them because of the Federal Government bureaucracy. That is what is going to happen.

Before I ask a couple of questions of this panel, I would like to insert in the record one paragraph of a letter from an individual named Bob Davis at Stromwell, Joseph & Gustavson who are benefit consultants.

I quote the letter from the second paragraph. "I am in the business of selling health insurance to small businesses, so I, as well as anyone, have a pulsebeat as to small business reaction to this law. So far in 1989, I know of five small businesses that have completely dropped their programs because of the paperwork nightmare, test-

ing costs and the 17.5 hour requirement." We can talk about that in a minute.

"All of these employers have provided at least health insurance for years and had every intent of continuing their programs. Senator Kasten, quite frankly the small businessman is getting fed up with the continued Federal Government intervention in businesses, as this case, benefits."

I just want to insert that particular paragraph in the record at this time. I would also ask that at an appropriate place a number of letters and some testimony from individuals in the Eau Claire area be included in the testimony, not interrupting the questions here but at an appropriate place in the record.

Dave, you employ how many people?

Mr. NELSON. I employ 10 people.

Senator KASTEN. How many of those are full-time?

Mr. NELSON. I have two full-time people.

Senator KASTEN. That roughly is a percentage of part-time/full-time that is typical in your business?

Mr. NELSON. Yes, it is.

Senator KASTEN. We had an individual yesterday in Manitowoc who is in the catering business. Obviously he had certain people who would work maybe 20 hours a weekend but might go 2 or 3 more weeks, and they would have met that 17.5 hour test.

In your view, what would happen to these people who are now on your large ratio of 4 to 1, part-time/full-time? What happens to that group of people if something like Section 89 passes?

Mr. NELSON. My part-time people would basically be nonexistent. I would go to all full-time. I would be forced to.

Senator KASTEN. Which would mean that you would have maybe five or six people without work?

Mr. NELSON. Yes.

Senator KASTEN. The people who were working would not have the flexibility they now have?

Mr. NELSON. Yes.

Senator KASTEN. Do you have any idea how many other small businesses find themselves in the same situation as you?

Mr. NELSON. I would guess in our community alone probably 90 percent of the businesses are in the same situation as I with mostly part-time people.

Senator KASTEN. It is part-time because it works for you, but it is also part-time because it works for them?

Mr. NELSON. That is right. That is correct.

Senator KASTEN. It is part-time in effect who need help the most. They need the income, and they need the coverage, and they need the job. They need the help the most, but it seems that Section 89 would hurt those people the most by, first of all, forcing them out of employment.

Mr. NELSON. Yes.

Senator KASTEN. Lois, after you have worked with a number of your different people, assuming Section 89 as proposed notwithstanding the fact that all the technical corrections and regulations still have not been printed. Do you have any sense of a scale or a set of fees of how much it would cost for you to come in to a business like Dave's, maybe a business of 50, maybe another business of

75 and go through the accounting work in order to go through the tests to show that they qualify?

I think it is important to point out in the United States of America you are innocent until proven guilty, this scheme as developed by the IRS and Treasury is one in which you are guilty until you prove yourself innocent by going through these complex and costly tests that Lois and others have been talking about.

You can pick the categories you like of 10, 20, 30, 40, 70 or whatever, but do you have a sense of how much time it takes you and how much it is going to cost your client in terms of administering these tests and getting the paperwork and forms all put together?

Ms. KRAUSE. When you are looking at the smallest employer, somewhere around 10 employees or less, just to conform to the paperwork in your initial year, you are probably looking at $300 to $500 of compliance, and that is no change in the employee benefit package. That is just taking it and doing the paperwork necessary and saying that we are going to retain the current benefit package and them, based on that, what are we going to have to do to comply.

On an annual basis, that same employer will incur an additional $100 to $200 because there are some reporting requirements that also have to be adhered to in Section 89 on an annual basis, which is the filing of a tax form to inform the Government that you have such a program.

So that would be your minimum cost. It would be an ongoing cost of $100 to $200 and an initial cost of $300 to $500 at a minimum. As your employee base grows, you probably also offer more employee benefits. As the number of employee benefit plans grow, therefore your cost grows.

Initial testing for discrimination and qualification of the plans can range between $500 and $1,000 if you employ a group of 50 people and an ongoing cost of perhaps $300 to $500 I would guess at this point.

After that, as your employee group grows to in excess of 100 employees, then you are going to have to probably have some of your own people spend a great deal of time accumulating this information.

Senator KASTEN. Or you will have to hire someone who will do nothing but that job full-time.

Ms. KRAUSE. Yes. At 100 people you probably would not have to hire someone, but you will certainly have to segregate some hours of your own personnel's time. So there is probably not a cash outlay for that. That is hard to quantify in terms of dollars.

Certainly they would also have the outside consultant's expense, again in that same range at a minimum of what we have talked about in the 50 employee group.

Senator KASTEN. I just want to say that the testimony has differed in terms of how much people think it is going to cost. A number of people have spent several thousand dollars already going to management seminars trying to figure out how to make this work.

Frankly, a lot of people are trying to figure out whether they can train someone in house to do part of the work or want to do it all with consultants, lawyers, or accountants.

The fact is, whatever happens it is going to cost money and we will lose health coverage. Those are the two bottomline parts of this.

You mentioned in your testimony that you are no longer doing the Section 89 homework because it is constantly changing. Let me just say in part for the record. The reason it is constantly changing is there is an uproar in America about this provision.

Section 89 began as an effort to increase taxes by some in the majority party on the Ways and Means Committee. Basically, they believed and still believe that all benefits to all employees under all circumstances and health care should be taxed. All of your benefits should be taxed.

If you are a flight stewardess on Northwest Airlines, the flight that you get for your trip to Florida on vacation which is a benefit that you receive because you are an employee of Northwest should be taxed.

If you are an employee of a men's store selling suits and ties, the 20 percent discount that you get because you work at the store when you buy your tie should be taxed.

They tried that in the debate and discussion of the 1985 Tax Bill. It was soundly rejected. At that point if you remember, we had Kasten-Kemp, Bradley-Gephardt and Packwood-Rostenkowski. It was soundly rejected.

We do not believe that we should tax every one of these kinds of benefits for all people. The complexity of regulating that is just impossible, and we want incentives in the system so people will provide health insurance and life insurance benefits. We look at the tax as a disincentive.

They ended up saying you win, but what about cases where you have highly compensated people who are doing one thing for themselves and a different thing for their employees? People said we are not sure that those cases even exist.

They said, well, if those cases exist we ought to go out and find a system to tax them so we will pick up Government revenue. That is how we got to where we are, because they wanted to pick up Government revenue and tax all benefits to everyone.

There has been no indication that there is any discrimination, let alone widespread discrimination, in small business in this area. The bureaucracy is the problem. The paperwork is the problem. The legal fees and the accounting fees are the problem.

The other point I wanted to make is that the Secretary of the Treasury, Nick Brady, recognizing that this was such a difficult issue particularly for small businesses to comply with, just made a decision that none of this will be enforced or take place before October 1, 1989.

We have since come along in both the House and the Senate, where I was the author, in the appropriations bill, the money that goes to pay for the Treasury, the IRS, whatever, their salaries, their day-to-day expenses. The money we appropriate to that department can't be used for the purposes of enforcing Section 89.

So in effect, Section 89 will not be enforced until the end of the fiscal year, beginning this fall. So we are going to get another year.

So in terms of where business stands right now, we are on hold. As the political situation stands right now, we are hoping that be-

tween now and the next several months we are going to develop enough political pressure to repeal Section 89, recognizing that it is a net loser for the United States and particularly a net loser for small growing businesses.

Businesses under 20 employees represent roughly 80 percent of the businesses in this State. We are not a State of huge corporations. What we have to do is to recognize that businesses like yours, Dave, are the ones that are the growing businesses.

You talked about highly compensated employees. The other point I want to make is that under the law you are a highly compensated employee if you own more than 5 percent of the company.

Let us just think of a couple of us starting a grocery store opposite Dave's or a used car lot or whatever. We could very well own 5, 10, 15 or even 50 percent of the company and our income could be $3,000, $5,000 or $10,000 that year from the company.

Yet, because we own more than 5 percent, notwithstanding the fact that our income would be very small, we would start to get into this whole process in which we would have to call up Lois and file all the forms just because we started off with a new small business and owned at least 5 percent of it. It is simply crazy.

I greatly appreciate, Dave and Lois, your testimony. Do either one of you have further comment?

Mr. NELSON. I have one further comment. As I said earlier, I have been in business a year and a half. Being a fairly new business, I think this would extremely hurt the new businesses because they operate on a little or no profit margin for the first couple of years, and that would make it even worse.

I, myself, have not been compensated at all for my first 1½ year's out of the business.

Senator KASTEN. Which is not unusual. That is so important.

Mr. NELSON. I realize that, but Section 89 would eliminate new business starts because of the costs involved.

Senator KASTEN. Lois, do you have any further questions or comments?

Ms. KRAUSE. No.

Senator KASTEN. I just want to say to both of you thank you very much and also apologize for the scheduling problems this morning.

Kurt, could you announce our next witnesses?

Mr. CHARTER. Now we have Gary Brown and Pat Quinn. Gary is from Figi's Inc. in Marshfield. Figi's Inc. is a mail order cheese and food business with 240 employees and up to 2,400 on a seasonal basis.

Pat Quinn is with Ayres Associates here in Eau Claire.

Thank you for coming forward. Please give us your name, title, and business address and tell us what your business is.

Senator KASTEN. Gary, why not go ahead. Welcome.

STATEMENT OF GARY BROWN, PRESIDENT, FIGI'S INC., MARSHFIELD, WI

Mr. BROWN. Thank you. I am Gary Brown, president of Figi's Inc. in Marshfield, WI. Our company has been in business about 45 years and is a mail order firm which offers cheese, meat and non-food gifts to people all over the country. Our primary business

period is centered around gift-giving holidays, namely Christmas. Our business, therefore, is very seasonal in nature. It requires employment of temporary or seasonal employees. These employees generally work from 2 to 6 months and 40 hours per week in that timeframe.

We employ 240 full-time employees plus 2,400 temporaries during our peak season. During 1988 we actually employed 3,900 different seasonal employees to average the 2,400 that we need.

We meet the Section 89 test when considering only our full-time employees. It is the quantity of seasonal employees which causes our firm problems in regard to meeting the Section 89 test.

Our firm is opposed to Section 89 and urges its repeal or, at a very minimum, major modification for a couple of reasons. No. 1 is the cost. We estimate that we will be spending approximately $50,000 on our consultant, additional clerical support, additional recordkeeping, and other Section 89 administrative costs. This is totally nonproductive money being spent.

The major cost we would bear would be providing health, life and accident benefits to our 3,900 seasonal employees. Our current health insurance program costs nearly $300 per month per family to the company, and another 3,900 families added to this cost is absolutely prohibitive to our company.

Also, the adverse impact of adding seasonal employees to our current health care plan would totally destroy our health care experience rating and raise the rate of health care for all our full-time employees.

The next point is kind of an administrative boondoggle. We must keep records that are not currently kept to do all the tests. The test formulas are complex and require the manipulation of a great amount of data.

An example is we must count the number of days each employee has worked as well as the weekly hours worked to determine if they are included in the test. There are two tests, the second test being a three-part test. There are more than three parts, however, because of the 90 percent/50 percent eligibility test and also the 50 percent eligibility test which prescribes an alternate test procedure for use under certain circumstances. So it is very complex.

Senator KASTEN. That last sentence sounds like someone in Washington wrote it.

Mr. BROWN. That is how complex Section 89 is.

Our seasonal employee profile is that most work less than 6 months. Most are students or people working on second jobs or people between jobs, retired people, handicapped people, people with poor prior work records trying to get another start in the workforce, and housewives.

I would say probably the majority of our workers do not require or do not want a full-time job due to a variety of factors, whether they are going to school, their family situation, if it is a second job, or they just like going to work part-time.

I think it is important to note that part-time work in our country is something that a lot of people like to do. Everybody does not want a full-time job.

Our alternatives to Section 89 remain limited. No. 1, and probably the main alternative we would look at is dropping our health care benefits for all of our employees. That is dramatic.

We also would be looking at things like resorting to increased automation in our businesses. The cost of providing health care to all of these employees would make it more cost effective to put in more automation, therefore eliminating the need for the employees.

We could also provide this health care benefit to our seasonal workers and cease to be competitive and eventually go out of business.

Just a point, not necessarily as to Section 89, but in the last couple of years cost increases which have basically come out of the Government sector and have dramatically affected our business are:

A postage increase in 1988 of 25 to 35 percent, depending upon where you were mailing;

In the State of Wisconsin and pending in the Federal Legislature is the minimum wage increase which dramatically affect our seasonal employment;

Now comes Section 89.

They just keep adding one layer on top of another, and eventually many of us are just going to go out of business because we cannot afford it. How much more can American industry absorb and still continue to provide employment and stay in business?

Then finally, if repeal is not possible we would like to see major modifications, including simplifying the administrative paperwork and raising the threshold for part-time workers in areas such as the number of hours worked per week as well as the number of weeks worked per year.

I thank you for the opportunity to present our ideas.

Senator KASTEN. Gary, I thank you.

You can add one more thing to that list. Some people in Washington want you to become the tax collector for 50 different States and about 75 or 80 municipalities. That is just one more that is coming.

Our next witness is Mr. Pat Quinn.

Pat, welcome. Thank you for joining us.

STATEMENT OF PAT QUINN, AYRES ASSOCIATES, EAU CLAIRE, WI

Mr. QUINN. Thank you. First of all, Senator, I would really like to thank you for coming to Eau Claire and allowing us the opportunity to testify here. This is a program that really affects all businesses.

In the company I represent, Ayres Associates, I am an officer, director and shareholder. It is a consulting, engineering, architectural, and planning firm. We employ 250 people in five States, and we have eight offices.

We have a self-insured health plan, and our understanding of the requirements in Section 89 for self-insured plans is that they are probably more complex than they are in the area of when you go out and purchase a health insurance plan on the market.

We have estimated that the cost for us in the first year to collect and to audit and to test and to maintain the quantity of paperwork is going to be in the neighborhood of $30,000 to $50,000. This includes the cost of having outside benefit consultants, legal counsel, corporations, auditors, and internal staff support.

It is imperative for our company that we take Section 89 very seriously. We are a Government contractor. A lot of our work is done for Federal and State governments, and we cannot afford to have a plan that would be ruled discriminatory in any way, shape or form. Our business cannot stand that.

Because of that, we would have to make sure ahead of time that we were going to comply with all of the provisions of Section 89, so we would probably have to spend more than some other companies in making sure that happens.

Our program right now costs us about $500,000 a year. If we spend an additional $30,000 to $50,000 just on Section 89, we are spending almost 10 percent of additional money just to comply with the Government regulation. We feel that this would probably likely result in a reduction in benefits for some of our employees because we cannot simply absorb that cost, nor is it likely we can pass it on to our employees or clients.

So we think the effect that Section 89 will have on our company is actually a reduction in health benefits to our employees, which is something we do not think Congress intended in the Section 89 legislation.

As a member of the architectural engineering community, we belong to a trade association here in Wisconsin called the Wisconsin Association of Consulting Engineers. In meeting with the people in our competitive firms, quite a few small firms under 25 people fully intend to drop health insurance coverage if Section 89 is implemented. They intend to do it by paying their employees an additional amount per month so that they can purchase on-the-market health insurance.

The effect of this will be threefold. One, it will raise tax revenues for the Treasury, no question about it.

Two, it will increase the cost of health care for these employees because buying individual coverage on the market is more expensive than group health insurance.

Third and probably the worst effect, a lot of these employees probably will not cover themselves with health insurance and will go uninsured. This will add to the health care problem that we have.

We urge the repeal of Section 89. We think it is bad policy. We think it is regulatory overkill. The enormous cost and complexity to businesses to be able to administer it are outweighed by any benefits that may be achieved. As we look at it, the only benefit to be achieved is increased tax revenues.

This will not improve benefits to employees. As a matter of fact, we believe it will result in less health insurance to employees and reduced benefits for those who still keep the insurance.

Again, just to conclude, we strongly urge the repeal of Section 89. Thank you.

Senator KASTEN. Thank you both very much.

These are two kind of niches that have not been covered in any of the hearings that we have had to date. Particularly, I just had not thought of what happens with you and Land's End and Gander Mountain and Wisconsin Cheese and Swiss Colony. That is a huge, huge impact on Wisconsin's economy. I know that because of the work that we are doing on some other issues, but I did not think in terms of all of the people that have as much of an increase in seasonal employment.

I guess you could turn that upside down for some of the people that are in the agriculture business, where you have the canneries and the pea people and the corn people and others. They have a season a little bit different than you, but they have that same problem. There will be a number of people putting 17.5 hours in for a very short period of time. They do it because they want to do it that way, and they do not want the other kind of job. This is the kind of job they want.

I just had not worked through that, and your individual plan does create some particular problems.

When you are talking of the revenue question, I think it is important that we might argue, that by grossing up the salaries and people going out and buying health insurance on their own, there are going to be a number of people who do not do it. That is a problem.

Going with the estimate they are trying to use of $120 million, that increased tax revenue is tremendously costly for America. It is a net loss for America. It might be a net gain of $1 million for the Treasury, but it is a net loss for America when we think of all these nonproductive costs that are going to have to go in.

Your estimate was what, Pat?

Mr. QUINN. In the first year, $30,000 to $50,000, and after that we estimate it will be $10,000 to $15,000 per year.

Mr. BROWN. We estimate $50,000 in the first year and probably in the range of $10,000 to $25,000 in the second year, depending upon how cumbersome it is. We have a large turnover of our employees, so we are tracking a tremendous number of seasonal employees.

Senator KASTEN. There is another slightly related issue that I just wanted to point out. One of the inequities today in the tax law is that if self-employed individuals, farmers for example, want to go out on their own and get the health care insurance they have to pay with after-tax dollars. They are not able to deduct their insurance.

If a company does it, as you pointed out, Pat, that is a tax deductible expense to the employer, to the corporation.

I should say as a third part, I am an author of legislation that would allow self-employed individuals, farmers, and so forth, to be treated the same way and would allow individuals to deduct their health care premiums the same way a corporation can deduct their health care premiums.

Right now, the law is that they would be switching to no coverage, but they would be switching from pre-tax to after-tax dollars. This would have a very, very negative impact on that group of people if that switch in fact were made. The insurance would cost them one-third to one-half more because they would pay for it in

after-tax dollars, which is another important point that is related to the efforts that you are making.

Let me thank you both for your testimony and for being here.

Kurt, that concludes the witnesses. I wonder if there are a couple of other people who want to say one or two words?

Mr. CHARTER. We had several people. Just about everyone who came indicated they would want to speak.

Senator KASTEN. There are two gentlemen there on the far side. We will ask that you summarize your comments.

Why not begin with you, sir, in the blue sweater. If you would just introduce yourself.

STATEMENT OF RAY PIETERICK, RAY'S PLACE, EAU CLAIRE, WI

Mr. PIETERICK. Senator, staff, news media and people in the audience, my name is Ray Pieterick. I own a small business, a tavern here in Eau Claire on Water Street. I also belong to the Eau Claire City Tavern League as a member of the board of directors. I am also on the board for the State Tavern League of Wisconsin.

Speaking in this capacity, especially on the State Board of Wisconsin, I represent over 12,000 liquor licensees to this State.

As you and I know, in our area of business we have a lot of seasonal operations in this State, especially up north such as resorts, campgrounds, ski chalets, hockey rinks, bowling alleys, golf courses, swimming facilities, and many more too numerous to mention. No doubt that a lot of those are all summertime operations. Some are wintertime operations. As a result, they depend a lot upon students, part-time help, and people working.

In conjunction with part-time help, a lot of them such as wives, husbands, and their family are working as part-time people to supplement their family's income.

As a result, no doubt one or the other spouse has insurance of their own already, so they are not interested in insurance, period.

No. 2, in the case of students going to the university here in town, I can attest. I have a son going to the university here who works for me. He can buy insurance cheaper through the university system than I can afford to pay for it myself on a family plan.

No. 3, in my own case of hiring four part-time and three full-time employees, it makes me decide to do one thing; that is, to lay off all my part-time help because I could not afford to carry insurance on them. That would mean going to seminars for schooling and teaching and all that.

As a result, I would even resort to the fact probably of having to close down 1 day a week to compensate myself for a day off if I have to.

Health policies would have to be offered to people who leave you. You have to give them that. They have to be covered under your insurance program if they are absent and not working for you anymore.

These are about the extent of the points I have wanted to bring forth to this chair.

Again, I want to say thank you for giving me the privilege to speak here before you.

Senator KASTEN. Thank you very much.

I think, again, that is part of this testimony that helps fill out the whole record.

As the previous two witnesses were in unique kinds of situations, clearly the tavern and resort industry is in a position which is special and unique, and it would have an adverse impact on you.

Sir, would you introduce yourself and go forward with your testimony?

STATEMENT OF STIR WAGNER, WAGNER'S LANES, EAU CLAIRE, WI

Mr. WAGNER. Thank you, Senator. I am Stir Wagner with the bowling alleys. I have 66 alleys on one side of town and 24 on the other side of town. We have about 110 employees, and 60 to 65 are part-time employees. They are kids that go to college, and they are seasonal. We usually employ them around the first of September to the first of April.

It would entail a lot of bookwork for us to incorporate them. Our company policy as it is now, they must work 30 hours a week and we cover them for 50 percent of the cost of the insurance. We give them the best policy we can give. It is $100 deductible and dental.

If we had to go to this other policy where you have to take care of all of the part-timers, we would have to go to a $500 deductible in order to keep the place solvent. It would put a strain on us.

As Mr. Pieterick says, when the employee is done we have to carry the insurance for 1½ years, and the bookwork with that is enormous. It would cost me about $15,000 a year just for a bookkeeper to keep the bookwork.

So I am for the repeal of it. Thank you, sir.

Senator KASTEN. Let me ask you both a question that I asked a couple of the previous witnesses. Have you sat down with your lawyer or your accountant or your health insurance experts and had any idea about how much complying with Section 89 would cost you in terms of nonproductive fees to different consultants, lawyers, accountants, whatever? Have you gotten down the road that far to know how much it might cost your company?

Mr. PIETERICK. We had a meeting with our insurance counselor out there and our CPA. I have an inhouse CPA, so there is no extra cost there. Someone else would have to pay that cost if they were to do it. They worked at least a month going over all their records to make sure that we were in compliance.

Senator KASTEN. Do you have any idea of quantifying how much it might cost?

Mr. PIETERICK. I talked to my CPA. He says to implement his programs you are looking at $500. He says from then on, all additional reports every year or semi-annually, the way the Government would prescribe it, it would be probably another $250 to $300 per year plus the insurance cost itself.

Senator KASTEN. Let me thank both of you for your testimony. Frankly, it is this kind of testimony that we need very, very much. The grassroots, the people who are employing people as we have had all day, the real story is a lot clearer in Eau Claire, WI than in Washington, DC where you are balanced off by different kinds of Government bureaucrats, the people at Treasury and others going

through saying, well, it is not that hard to comply and the forms will be easy.

This is the kind of testimony, not only yours but the testimony that we have received today that is very, very important.

So let me thank you both very much, and I am sorry to have inconvenienced your schedules. Thank you for being here, and thank you for your important testimony.

If there are no further individuals who would like to speak, I would like to adjourn this hearing with thanks to all of you who have participated.

This hearing is now recessed.

[Whereupon, at 11:05 a.m., the hearing was recessed.]

THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE ON SMALL BUSINESS

WEDNESDAY, AUGUST 16, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
La Crosse, WI.

The Committee met, pursuant to notice, at 2:10 p.m. in the City Council Chambers, La Crosse, WI., Hon. Robert W. Kasten, Jr. (Acting Chairman) presiding.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. I would like to call this hearing to order.

I would first of all like to say welcome to all of you. This hearing is a hearing jointly sponsored by the U.S. Senate Small Business Committee and by the Small Business Administration of Wisconsin, in particular the SBA Advisory Council.

This is a hearing which is part of a series of eight hearings which I am conducting in Wisconsin: Green Bay, Appleton, Manitowoc, Sheboygan, Eau Claire, La Crosse, Madison, and Milwaukee in order to determine the impact of Section 89 on small and growing businesses in our State.

As a Member of the Small Business Committee, we have had a number of hearings in Washington with testimony from the IRS, Treasury Department officials, and different affected individuals.

During this August break, I and other Members of the Small Business Committee felt that it was important that we gave people in our States an opportunity to testify with regard to the effect of Section 89 on what was really going on in the world.

The difficulty is that lots of people cannot come to Washington to testify, and the testimony that you get inside the beltway is different from the kind of testimony you get in Washington.

So this week and next, a number of my colleagues on the Small Business Committee, Republicans and Democrats as well, are holding these hearings in their States.

We have with us today Rob Gifford, who is my Small Business Committee representative in Washington, and our official court reporter from the Senate Small Business Committee.

The comments and the information that we gather here today will be included in our overall set of hearings on the effect of Section 89, so that this is part of a nationwide ongoing effort to try to determine the effects of Section 89.

I said that we were also working with the Wisconsin Small Business Administration in helping us organize the witnesses today, and I would like to briefly introduce to you Kurt Charter. Kurt is the head of the Small Business Administration efforts for the State of Wisconsin. He is based out of Madison. Kurt has been helping us arrange witnesses and arrange for these hearings. We appreciate the help of the SBA, particularly, Kurt, your personal help.

Let me introduce you for questions, and you can start our witnesses.

STATEMENT OF KURT CHARTER, DIRECTOR, STATE OF WISCONSIN SMALL BUSINESS ADMINISTRATION

Mr. CHARTER. Thank you, Senator.

I am pleased to say I am the State Director for the Small Business Administration and to have this opportunity to acquaint many in the room with the fact that SBA has an advocate role to help you, to help the Senate Small Business Committee and to help Congress look closely at the impact of red tape intensive regulations and laws on small business.

SBA is recognized for its loan guarantee program which provides $200 million in long term growth financing for Wisconsin this year which will be a record, for a working partnership with the University of Wisconsin through its Small Business Development Center operation which is located here in La Crosse, one of the locations, and also with the local Chamber, our executives' voluntary chapter for training.

Our role here, however, is as an advocate, and we appreciate your coming to Wisconsin or back to Wisconsin, home to Wisconsin to provide an opportunity for the small businessowners and the customers and clients of small businessowners to comment on this important issue.

In our effort to bring the people here and let them know what is happening, I would like to acknowledge the existence of our Advisory Council, the Independent Business Association of Wisconsin, the Wisconsin Association of Manufacturers and Commerce, and the International Federation of Independent Business.

Senator, today we have eight witnesses. We would like to call them up two at a time. When they come forward, if they would come to 16 and 17 here where we think the mikes are on and if they would provide you with their name and their business and how many employees they have as they start their testimony, we would appreciate it.

First, I would like to call Mary Jo Murphy of Halverson, Riutzel & Co., an accounting firm, and Bill Heinz from Nob Hill Restaurant.

Mary Jo and Bill, if you would come up.

Senator KASTEN. This atmosphere we have today is more like a court chamber than I am used to.

Let me say thank you to each of you. The full text of your prepared remarks will appear in the record as if read, and I would ask that you summarize your remarks in 5 minutes or so. We will ask for each of you to speak, and then we will come back and do some questions and some comments back and forth.

So Mary Jo, why not go ahead. Welcome. I thank you for appearing before us today.

STATEMENT OF MARY JO MURPHY, HALVERSON, RIUTZEL & CO., LA CROSSE, WI

Ms. MURPHY. Thank you. My name is Mary Jo Murphy, and I am an attorney and CPA with Halverson, Riutzel & Co. Our company employs 17 individuals, but we have over 200 clients with small- and medium-size businesses.

As far as Section 89 is concerned, there are basically four comments that I would like to make. I took a poll of about 10 percent of our client base to get a feel for what their impressions of Section 89 are.

The first one is most individuals stated that they did not understand what Section 89 was or the difficulty in enforcing it.

Regarding administrative rules as far as who was to comply with Section 89, which I related to them was everyone, they had problems wondering why there were so many administrative tests, that this was going to cost them extra and they were going to have difficulty in paying for this additional administrative cost without even considering the increase in paying for these fringe benefits.

There is a four-part test and a two-part test and then a highly compensated employee test and then a discrimination test, and they had difficulty in wondering why there was no small business exception, frankly.

The other thing that they had a problem with was if they made a mistake in the testing of employees that the employee was the one that paid the penalty.

Another comment was that for a small businessman, premiums for increased insurance coverage for all their employees were going to be very difficult for them to pay for. In addition to the administrative cost, they are now going to pay additional health cost premiums.

For our firm in particular, our insurance costs increased 58 percent just as an insurance adjustment. Our 17 employees are all covered, but we had a 58 percent insurance premium increase.

Large firms can self-insure, or due to the volume of employees their premiums per employee are lower than the small businessman, so they thought it was unfair that they have to bear the burden of this.

Another point that an individual brought up is it does not really encourage the merit system. For instance, rank and file employees work from 9 to 5, and that is it. An employee who does well or does exceptionally, employers are interested in giving them a fringe benefit. One of them is health insurance premiums covering either accident and health or group life.

Rank and file employees are paid an hourly wage, and they are covered in the retirement area. They were wondering if the merit system was somehow thwarted because exceptional employees now get no additional benefits. The fringe benefits have to be covered for all employees.

The last comment, the most frequent, was with the increased administrative nightmare, as some of them termed it, they were

going to just not have health insurance at all. They were just going to cut out their premiums and not allow that benefit, which in effect is going to hurt them because good employees will go elsewhere.

Those are basically the four comments I wanted to make.

Senator KASTEN. Mary Jo, thank you very much.

I am going to ask Bill to make a couple of comments, and then we will begin with some questions and some comments along with some particular comments that I have. I think we might want to lay out exactly what Section 89 is, and I will do part of that after your comments, Bill.

STATEMENT OF BILL HEINZ, NOB HILL RESTAURANT, ONALASKA, WI

Mr. HEINZ. Thank you. My name is Bill Heinz. I am the owner and manager of Nob Hill Restaurant in Onalaska. We employ a base of 39 employees on a year-round basis.

I guess, first of all, I would like to thank you for your help that you have given and tried to give as far as the repeal of Section 89 is concerned. We appreciate all that support and hope you will continue after these hearings.

Of the 39 employees that I employ, to put this in the perspective of a single business person, 20 of those employees are married, eight are not married, and 11 are high school students. The total cost of an insurance package to insure all those employees at either family or single coverage that they would determine based on a 17.5 hour proposal would be $41,712 for an annual premium.

Again, to put it in perspective, last year my sales were $940,000 with a negative net taxable income, but after adjustments for depreciation and so on we did have about a $20,000 cash position.

Depending on the cost sharing position of the Section 89 proposal as well as the mandated insurance proposals that are following closely on its heals, anywhere from 50 to 80 percent of an employer paid premium would cost me from $20,800 to $33,300. It is plain and simple that I cannot afford it. Even if I just insured for single coverage, it would cost $19,152.

The end result is that I did prior to Section 89 have my key employees insured as a benefit for employment, and as a result of Section 89 they have lost that benefit. That also includes my own personal coverage which has been lost as far as a taxfree situation.

I have, however, moved on to an IRS Section 125 Program or a Cafeteria Plan for the use of pretax dollars so that I could extend some benefit to my employees. In the hope of compliance I have spent approximately $400 so far this year with my CPA and attorney to come up with a program of compliance, and as far as we can determine we meet the compliance and we have passed the rules; however, no one is really sure of that.

We believe, as I said, that we are in compliance. Then again, when you bring up the 90 percent rule which has been talked about and other compliance regulations that have yet to be clarified, we may not be. Again, between a CPA and an attorney we are not sure of any of it.

The program is difficult at best to administer, and the penalties for noncompliance are certainly excessive as well as the cost to the Federal Government to enforce the program.

The cost of the intent of the law is too excessive to insure all the people that work for you, especially when you consider a mandated health benefit package that was recently introduced by Senator Kennedy.

As a member of the Wisconsin Restaurant Association and the board of directors of the local chapter, I come in contact with a number of restaurants. In this marketplace alone, 15 restaurants have closed in the last year due to the lack of sales and, obviously, profits. The ones that are still left operating are also complaining about a backward movement in sales and, at best, a plateau.

This bill is an inflationary bill. We are a very highly competitive industry, and in the restaurant business even the least cost of insurance would bring my menu prices up at least 10 percent to compensate. When we raise prices, we create a spiraling downward effect because we raise prices, lose customers, raise prices, lose more customers, and so go the profits.

If a bill like this is to remain in effect and a health mandate comes along on its heels, it would not only destroy all of our profits and raise our prices, but it would also certainly contribute to unemployment. It is much more practical to give an insurance package to someone who works 30 hours a week as opposed to 17.5 hours a week; therefore, the loss of part-time jobs will be substantial.

According to the Restaurant Association of Wisconsin statistics, we are the largest retail employer in the State. We employed 142,000 people in 1987, and we have added an average of 4,100 jobs to the employment rolls since 1983.

We generate $2.9 billion in sales, with $147 million of that going to the State in the form of sales tax. So we do handle a lot of money for the State as well as for the Federal Government.

What this bill is causing us to do is go backward in the areas of employment as well as profits. The cost to the State due to more closings and loss of jobs will be substantial.

As employers, we need some method to retain good help. An insurance package like this is a benefit earned. It is not the right of every person that works for a small business to be insured by his employer. Small business simply cannot afford to make these kind of payments that have been placed on them by the State as well as the Federal Government.

The bill was initiated for probably one of two reasons, either to take care of the uninsured or to raise tax revenue for the extra payroll situation. Basically it has done neither, and the bottom line is that the people who did have insurance before do not have it now. The law has caused problems in every type of business that has tried to work with the law at either considerable expense, or some have just totally ignored it because they just do not understand it and do not understand the repercussions of it.

In conclusion, a law like this addresses some of the problems, but it solved none. A repeal of this law would at least benefit the economy.

Senator KASTEN. Bill, thank you very much.

Let me explain the genesis of all this, in fact there were some in Washington who wanted to raise taxes without changing tax rates. What they wanted to do was tax all benefits, the beginning of this going back to when we had Kemp-Kasten, Bradley-Gephardt, Packwood-Rostenkowski, and the Treasury involved with so-called tax reform.

There is a small minority of people who wanted to tax all benefits. They believed that health insurance should be taxed to the person that gets it. Life insurance should be taxed to the person who gets it, that the airline ticket for a flight attendant on Midwest Express gets for herself to go on a vacation should be a taxable income, that if I bought a tie at a men's fashion store where I work with a 20 percent discount should be taxed.

This group of people simply wanted to tax all benefits under all circumstances for everyone. Well, a large number of us were very opposed to that, and they were a minority within a minority. There was no hope that they were going to include that with tax reform, and it is lucky that they dropped the plan almost completely except for this one little part of it that is left over where they said, well, what about instances where a small business is discriminating and giving certain benefits to certain employees and not extending it to others.

We said if that exists, go out and find it, and that was the beginning of Section 89. Now even the people who authored the tax bill are running away from it. The only question is whether we want to reform Section 89 or repeal it.

The problem is, as Mary Jo suggested, that a large number of people because of Section 89 are going to be without any kind of health insurance. For an average business in Wisconsin, and roughly 80 percent of the businesses in Wisconsin are 20 people or less, they will take one look at the penalties and another look at the four or five different tests that they have to go through and will decide they cannot afford the accounting and legal fees in order to put them through the hoops.

They are going to drop their health benefit plans and life insurance plans for all employees, possibly gross up their salaries to cover cost.

The net result is a large number of people in our State will be without health insurance when our national goal is to have more people covered by health insurance programs. In the end, that is the real problem. We will not have as many people covered by small business for health insurance at a time when we need health insurance. We need incentives, not disincentives.

Now Mary Jo, with regard to what I just said, could you give me any indication, based on your survey, of how many people are in that last category described who are basically saying I just cannot go through the legal, accounting, and consulting fees, the benefit package fees. I will just drop my plan for everyone? Did you run into a significant amount of those people?

Ms. MURPHY. The majority did. The administrative costs are too high, and the insurance costs are too high for the small businessman, that he is willing to drop that type of fringe benefit, in fact drop fringe benefits in general because it is too much of a burden for him.

Senator KASTEN. Bill, I know you are here speaking on behalf of the restaurant association. I wonder if you could address the full-time versus part-time employee question.

You have a number of people who work for you full-time. You also have an equal number who work for you part-time. Of those people who work for you part-time, many of them want to work for you part-time. In other words, that is what works best for them.

Mr. HEINZ. Right.

Senator KASTEN. How many of them are kind of in that category?

Of that group, my guess is that a large number of them are spouses or have other jobs and are covered by insurance somewhere else and are part of another package.

Mr. HEINZ. That is correct.

Senator KASTEN. In effect, what Section 89 would be doing is forcing people to provide certain kinds of insurance and increase costs to people who do not want to work full-time and are covered somewhere else in the process.

Could you talk to that question a little bit?

Mr. HEINZ. Yes. In my case I have 39 employees. More than half of those are part-time. When I say part-time, I will use the number of 25 hours. When you use the number of 17.5 hours, almost everyone is full-time because no one works 17.5 hours. They are all over that.

Of those, 11 would be high school age and therefore not affected. In my situation I would have 28 of 39 employees who would be eligible or should be offered some insurance package.

Of those people, 20 of them are married, and I know that 12 of those do have spousal coverage because when we instituted the Section 125 Program we offered the benefit to anyone that wanted or needed coverage. Approximately eight of them took it, and there were four more that declined it.

Again, the potential would come up that when you introduce a cost-sharing basis, whatever that percentage may be, if it gets into the 80 to 90 percent cost bracket, a lot of them will elect to take the coverage because, why not, just for the co-insurance program, not realizing that two insurance companies are not going to pay off on the same program. So it would be a substantial increase in cost to me.

Also if I could, I would like to say that as far as dropping coverage, to answer the first question as to myself and also for the restaurant industry, we have discussed this at a couple of meetings. I know of only one restaurant in the area that did do anything as far as coverage. The rest just simply dropped everything they had and grossed up the salaries. So there are a lot of people who did have coverage and now do not. I am the only one in talking to them who did anything as far as a Cafeteria Program or something on the back side of that.

Senator KASTEN. Let me just say that especially with groups of 20 employees and less and, even more, 10 employees and less, in my hearings that we have had now for the last several days and the information that we are getting from other places around the country, significant numbers of people are simply dropping their coverage, meaning that people who had health coverage 1 or 2

months ago will no longer have any health coverage at all at a time when our hospitals are having an increasing number of uninsured and underinsured individuals to deal with. It is creating a whole problem, particularly in rural areas, but we will not get into that.

Let me just say thank you to each for your testimony here today. It is important, and I appreciate the fact that you took the time and also have gone through the work in order to prepare for today's testimony. Thank you both very much.

Kurt, who are our next witnesses?

Mr. CHARTER. Senator, we have Dave Schlueter, a CPA with Hawkins, Ash, Baptie here in La Crosse; and Harry Turner, human resources manager of Webster Industries in Bangor.

Dave and Harry, if you would come up.

Senator KASTEN. Gentlemen, thank you both very much for joining us. We will begin with Dave Schlueter, Hawkins, Ash, Baptie, CPA.

I might make a comment. This is the first time we have had two CPAs back to back, but it is very interesting and important, I think, to recognize that a number of people who make money on the complex laws that we pass are upset enough about Section 89, notwithstanding the fact that it is going to be a revenue producer for them, that they are willing to come forward and talk about this.

That has to be a sure indication that we have gone over even the boundaries that we normally establish with the red tape and bureaucracy and paperwork and forms when legal experts, accounting experts and health plan consultants all have come to us and said I am not only concerned about what you are doing to my law firm or my accounting firm or my benefits company but this is just impossible even for us to understand and it is not fair or right.

Dave, the fact that you are here as a second CPA I think is very, very meaningful. I particularly appreciate your being here today.

STATEMENT OF DAVE SCHLUETER, CPA, HAWKINS, ASH, BAPTIE

Mr. SCHLUETER. Thank you very much, Senator. I will try to summarize my remarks without reading all this.

First of all, with regard to the qualification rules under Section 89, some of the sanctions and the penalties are just outrageous. When you consider the fact that an employer's plan could possibly fail the qualification rules and all of the employees are imputed income when that happens, that is just a ridiculous rule.

In regard to the discrimination test, I have just plain given up looking at them. I just do not think they will ever become law. They are so complex and incomprehensible, it is just very difficult to explain to most people.

Personally, our firm has about 150 employees throughout the State and in Minnesota, and we do offer health benefit plans. We also offer a Cafeteria Plan. It has been my responsibility to make sure that those plans qualify.

In the past 1½ years since the Tax Reform Act of 1986 came out, I have probably spent approximately 300 hours working on Section 89; that is, I have attended four seminars and given two or three

seminars, I read the laws, I read the regulations, I read articles explaining them, I have looked at software to do the test, just on and on.

Basically, I think I have wasted 300 hours of my time. Out of those 300 hours I probably have been able to bill the client 40 hours. That is a charge percentage in accounting terms of 13 percent which we could make no money on if we had kept that up. It has to be at least 50 percent.

Thus, the law has been just a terrible misallocation of some of our resources.

In talking to clients, I have tried to impress upon them to meet the qualification rules simply because of the outrageous penalties that are involved, but even in trying to meet those rules there are some pretty hefty costs involved. When you have to have a written document and it has to be all encompassing, I have heard quotes from various insurance people that this will cost approximately $700 and up. I suspect it will be more.

That is only a one-time cost just to get a written document when they already probably have all kinds of written documents from the insurance company and contracts and everything else. Just to expect them to have to have this in writing in another form and pay another cost is a travesty of justice in my opinion.

I think at the heart of the problem is the way the legislation has passed through Congress. The Tax Reform Act of 1986 was an 11th hour proposal basically between two people, Rostenkowski and Packwood, and they rammed it through Congress with very little debate because it was done in late October 1986. I think the people of this country deserve more and even desire more laws which are more thoroughly thought out.

I do fully appreciate your stance on Section 89. I think that is the only way to go, to repeal it. The real heart of the problem in my mind all along has been what is the real issue. Is the real issue discrimination, or is the real issue a Health Insurance Program for everyone, whether they be nationalized or what? To me, that is the real issue, and I think we ought to address that. The only way to address that is to repeal this legislation and go at it again.

I thank you.

[The prepared statement of Mr. Schlueter follows:]

August 16, 1989

U.S. Senate Small Business Committee:

Thank you for the opportunity to express my views on Internal Revenue Code Section 89.

As a practicing certified public accountant and a tax partner in our firm, I would like to say that Section 89 is an example of very poor legislation. If its intention was to eliminate discrimination in the health benefits area between the highly compensated employees and those that are not; then why should all employees have to pick up income on the benefits received when the employer's plan fails the qualification requirements. That just puts a greater burden on the non-highly compensated, since these employees can least afford to pay additional taxes on benefits received. This is an ill-conceived sanction, to say the least.

The discrimination tests in Section 89 are almost incomprehensible. After many readings, one may begin to understand them, but then the implementation becomes almost impossible. A business may believe it has two health plans, but because they offer the employee a number of choices, there may be nine or more plans. Employers would have to allocate many resources and man hours to try and comply with the discrimination testing procedures.

Personally, I have spent about 300 hours on Section 89 matters in the last year and one half. I've attended four seminars on the subject, participated in two others, read the law and regulations a number of times, wrote memos to clients and staff trying to explain the law, reviewed software for testing, and have read and researched many articles, books, etc., on the topic. What's been accomplished? Not much, considering that Section 89 may never take effect. Of my 300 hours, about 40 were billable, that's a charge rate of 13 percent when it should be 50 percent. In all probability, it's a terrible misallocation of resources.

Most of our clients are small businesses, and are very frustrated with Section 89. We are unable to give them proper direction and advice because of the lateness and lack of meaningful regulations on the subject. In addition the law is difficult to interpret and deadlines are constantly being postponed. To date, our clients have not spent a great deal of time and money to comply with Section 89. We have advised them to meet the qualification rules, but even this could be costly. Someone has to write a plan document and I've heard prices quoted of $700 and up. Testing could cost thousands of dollars. This is just another added burden to these businesses since most already have plans that comply.

Congress has dropped an atom bomb on an ant hill when a can of "Raid" would have worked. We need laws that are more thoroughly researched and reviewed before they are passed. There must be more concern from our lawmakers for the cost of implementation instead of simply worrying about the increase or decrease they will cause in tax revenues. We do not need tax legislation agreed upon by two powerful lawmakers and then rammed through Congress at the eleventh hour. The people of this country disire and deserve better procedures than that. If a person in business would have proposed and pursued this law as Congress had, they probably would have been fired.

One final comment. Much of the tax legislaiton in the last 10 to 15 years, has directed Treasury to issue regulations which have the effect of law. This means we operate and file tax returns for a number of years before we even know what the law of the land is. Is that the way our goverment should operate? It causes taxpayers to incur additional expenses and often costly litigation. Can't Congress write laws that can be understood? Our forefathers worked very diligently to approve a constitution that separated the powers of our government. I think it's time Congress take a hard look at who is actually making the laws we live under.

Sincerely,

David Schlueter

David A. Schlueter, CPA

Senator KASTEN. Our next witness is Mr. Harry Turner.

STATEMENT OF HARRY TURNER, HUMAN RESOURCES MANAGER, WEBSTER INDUSTRIES, BANGOR, WI

Mr. TURNER. Good afternoon, Senator Kasten. My name is Harry Turner, and I am human resources manager for Webster Industries in Bangor, WI.

We are a medium-size employer. We have about 400 employees, and I would like to thank you for this opportunity to be part of this hearing.

Because of the great uncertainty concerning modification of Section 89 or even possible repeal, we at Webster Industries have pretty much taken a cautious wait-and-see approach, but as the law now stands we feel that Section 89 could adversely impact upon us in the following ways.

1. We, like everyone else, are concerned about the costly and complex task for us to develop and maintain a relevant data base for compliance testing.

2. Also, we are concerned about what the vague definition of what actually constitutes a plan under Section 89.

If we should inadvertently misinterpret one of our highly utilized benefit programs and neglect inadvertently to put the plan in writing, for example, as I understand the law our employees could be socked with an actual unexpected tax bill for the value of the benefits which they received. So that is of major concern to us.

3. We are also concerned about Section 89's requirement for separate testing of employee and dependent coverage under the Health and Dental Plans. Many of our employees have spouses who work outside the home on a full-time basis.

Some of our employees may sometime in the future decline the coverage that we offer in our plans because they are covered under their spouse's plan. We feel that this could result in our plan failing to meet the 80 percent test and thereby requiring us to then meet the more complex tests of Section 89.

At best, even with sworn employee statements those have a limited shelflife, and it creates more recordkeeping and followup for us.

4. Our fourth concern is that not all of our employees have the same needs. We feel that our benefit dollars might be better utilized if we offered our employees a cafeteria type benefit program. As it stands now under the law, we are reluctant to even think about implementing such a program because we are afraid that with IRS interpretations and so forth the plan would fail the 80 percent coverage test. Then we get into the more complex testing that I mentioned earlier.

5. Also at various times during the year we have peak workload requirements, and during those times we use a number of part-time employees, and we also use other personnel from temporary help agencies.

Section 89's requirement to provide benefits for part-time and temporary employees who work at least 17.5 hours per week could definitely increase our group insurance costs.

We are also concerned because Section 89 would require us to include personnel from temporary help agencies when we do compliance testing for our clients, thereby making our compliance more difficult.

Finally in closing, one other point that I would like to make, having worked 4 years in the health care industry as personnel director at a Milwaukee Hospital, in looking beyond the wood products industry to the Nation's health care industry I personally see a 17.5 hour rule as having a very adverse impact upon the Nation's hospitals who by necessity utilize a large number of part-time employees.

I feel that this increased expense to health care providers is without a doubt going to be passed along to the health care consumer. This would be in the form of higher group insurance premiums and higher utilization cost, and I don't think we want to add on to the health care inflation rate in the health care industry now.

I thank you again for the opportunity to voice our concerns here.

Senator KASTEN. Harry, thank you, particularly for that last point because that is a point that has not been brought up. Because of the nature of these hearings, we really have not heard from a clinic or from a hospital. Maybe if it is not too late we might try to get one because, clearly, large numbers of hospitals use significant proportions of part-time help and flexibility.

Let me make one other comment. You were worried because of the fact that your work force gains and loses. Sometimes you add employees. If you stop and think of the seasonal nature of the business like Figi's, for example, who does most of their cheese during the Christmas season, they have testified before this Committee this morning in Eau Claire. At one time or another they go from a couple hundred employees to 2,300, and then they go back down. To get that 2,300 they have to deal with about 2,900 who are working with them at different points.

So if you stop and think of companies that are in very, very cyclical businesses, my guess is Company Store would be that kind of example, Land's End would be that kind of example, clearly Swiss Colony, Figi's, Wisconsin Cheese. Large numbers of people in Wisconsin have this impossible process where you have a couple thousand people coming in to work for them at all sorts of flexible hours, nights, days and weekends.

It is employment that is important to Wisconsin, and not only would health benefits be at risk but those jobs would be at risk if we ended up with a complex system such as Section 89. I thank you for pointing that out.

Dave, let me also agree with what you said. You heard me say this whole process began because there are some in Congress who want to tax all benefits to everyone under all circumstances, but you are exactly right. This was a part of the Packwood-Rostenkowski negotiations that in effect fell through the cracks. Now both of them are walking away from it saying that is not what we meant.

The only question we have before us is whether we want to reform it, fix it around it around the edges, or repeal it. I feel very strongly that there ought to be repeal.

You have had enough experience with laws from Washington to know that once something gets there it gets tinkered with every other year. We will start to maybe make the number of employees of a small business that is covered reasonable this year, and we might even be able to define a highly compensated employee this year but then we will redefine it next year. We are going to be back and forth on this, and the position of employers is going to be impossible.

Harry, you are right to not worry too much about Section 89 in terms of spending money on it for the next year or so.

Basically, what has happened is in the House of Representatives more than half of the Members of the House of Representatives signed on the bill to repeal Section 89, of which Steve Gunderson is a leader in this group. Because of procedural and tactical reasons, a vote has not yet occurred, but they are going to force a vote in the House of Representatives.

In the Senate we also have more than half on record against Section 89, and we will continue working on it.

An indication of the trouble with Section 89 is because of all the controversy because the regulations were not out and the technical corrections were not through, we ended up with the Secretary of the Treasury himself saying there will be no enforcement, no Section 89 compliance, and no Section 89 for practical purposes until October 1 of this year.

Last week both the House and the Senate in the appropriations bill said none of the money in this bill for the appropriations of the Treasury and IRS could be used for the purposes of enforcing or working with Section 89. That is in the House and the Senate bills.

That Treasury-Postal appropriations bill will pass and be signed into law by the President. That effectively means that Section 89 will not be. We have not given the IRS and/or Treasury any money to enforce or work with Section 89 for the entire next fiscal year. The fiscal year that begins this fall and would end in October 1990.

That is where we stand right now, it gives us an opportunity to try to have these meetings and hearings and to get more information on the real impact and hopefully repeal Section 89 before next fall. I am optimistic that we are going to repeal it this fall because of a growing effort.

I wonder if you could respond, Dave, because you have met with a lot of different people, on the question of what people's attitudes are going to be, particularly the smaller ones. Is there a significant number of people who are simply going to cancel their plan completely leaving large numbers of people without health coverage just from the work you have done so far and the people and the clients and seminars you have been at?

Mr. SCHLUETER. There has been a lot of talk about that. I do not know how many actually would follow through with that.

When you are talking about small businesses, there are already small businesses that are operated as partnerships or sole proprietorships where the sole proprietor or the partner already does not get a tax deduction for his health insurance premiums that he pays. It is very difficult to tell what they would do with their employees.

They do talk about that, but I cannot give you a definite answer of how many specific people we would have.

Senator KASTEN. Before I get the next panel, let me say that you touched on another part. It is not essentially a section 89 problem but it is an insurance health care problem.

It is very, very important in Wisconsin where we have large numbers of self-employed individuals, particularly in the agricultural community, that are not part of a large company. So they are caught in the situation that you just described.

Health care premiums are deductible to a corporation. They can deduct their premiums as an expense of doing business. Health care premiums are not deductible to an individual.

I have introduced legislation that would treat individuals and corporations the same way, and the self-employed individual, the sole proprietor, would be able to deduct his health care cost. His monthly health care premium can be deducted just exactly the way it would work if he went to work for XYZ corporation and the corporation would deduct it.

I think that we simply have too many underinsured and uninsured people in our State right now, and one of the reasons is that we have not treated self-employed people the same way that we have treated corporations.

Mr. SCHLUETER. Could I add one comment to that? We now have a lot of people with S corporations, and 2 percent shareholders are also subject to that same rule of not being able to deduct their health insurance premiums. Because of the laws in the last couple of years, we have a lot of S corporations. We have more than we ever had before, and it is more of a problem.

Senator KASTEN. Well, I would have to look into that with subchapter S.

Mr. SCHLUETER. Because they are treated the same as partnerships.

Senator KASTEN. It is treated the same way, and that would carry over. It is just the opposite of what we want. We want incentives for people to have health care programs, and these are all disincentives.

Gentlemen, thank you. Thank you both very much for your testimony. We appreciate your being here.

Kurt, how are we organized now?

Mr. CHARTER. Senator, we have two panels remaining. In the next panel we have Tom Kennedy of the J. F. Brennan Co.; and Mike Engel. Mike is general counsel for Midwestern National Insurance Corp.

Of interest to me certainly and perhaps of interest to them is that Wisconsin has the highest percentage of small businesses, small versus large, of any State in the Midwest; 98,000 approximate businesses in Wisconsin have employees, and about 80,000 of those have fewer than 20 employees.

The effect of making it difficult to go into business or to be in business thus has a greater effect on Wisconsin than in some of our competing States.

Senator KASTEN. OK. Our first witness is Mr. Tom Kennedy.

STATEMENT OF TOM KENNEDY, CPA, J.F. BRENNAN CO., INC., LA CROSSE, WI

Mr. KENNEDY. Thank you, Senator. I am the secretary-treasurer and stockholder of J.F. Brennan Co. here in La Crosse. Our company has approximately 100 employees at the present time, comprised of 84 union construction personnel and 16 office and shop personnel that are nonunion. We employ skilled union personnel, operating engineers, carpenters, laborers and, on a limited basis, ironworkers.

We operate primarily in the upper Midwest and deal with approximately 17 different union locals of the various crafts. In each craft, in some cases each local will have their own health and welfare program to which we pay 100 percent of the required contribution.

Our 16 company people are covered under a separate health, dental and life program, and each person is entitled to the same identical benefits regardless of position or wage scale. Our company pays 100 percent of the premiums for all employees, again without regard to position or wage scale.

When Section 89 was first passed, therefore, I was not too concerned about its provisions because we have never discriminated between highly compensated and nonhighly compensated employees in any of our benefit programs. I assumed that the content of Section 89 was directed at firms that provided benefits to the highly compensated employee and reduced or no benefits to the

nonhighly compensated employee. I was soon to learn that this was not the case.

I attended a seminar in November of 1988 that was taught by a national benefits consulting company. The seminar took approximately 4 hours, during which my blood pressure kept rising and I actually became angry that a group of legislators could pass such a bill.

It became apparent that the bill was not only social legislation but it evolved into tax legislation. The so-called experts teaching the seminar could not answer all the questions because they did not have a clear understanding at the time of what Section 89 said.

I was so confused by the content of this seminar and the lack of understanding by the experts that I knew I would have to attend additional seminars.

My parting comment on leaving was that all legislators should attend one of these sessions and attempt to apply the testing procedures to a real life situation.

I did go to two additional seminars, each of which was equally confusing.

I must also add that I am a certified public accountant, your third one today, and I have been trained to read and understand complex accounting rules and regulations and equally complex Federal and State tax regulations. This background, however, apparently did not prepare me for the complexities of Section 89, nor did the experts at the seminar seem to comprehend it.

Most of them expressed the view that because our plan had highly compensated individuals that were married and the nonhighly compensated individuals were single, we would not be able to pass the nondiscrimination test. It did not matter that both groups received the same health benefits, only that we paid more for the premiums for a family plan as opposed to a single plan.

Also, I assumed that we only had three plans, health, dental and life. Under Section 89, however, each benefit option, each level of employee coverage, each level of family coverage and each level of contributions is a separate plan. We therefore would have a minimum of six plans to test for the nonunion employees and an unknown number of tests for the union people.

Subsequent to these seminars, our insurance agent and I spent 3 hours attempting to do one of these tests. It became apparent that a computer would definitely be a necessity for these tests and that perhaps outside consultants might have to be hired to do the actual testing.

Our agent inquired as to the cost of an outside consulting firm performing these tests and was quoted a price of $14,500 for a firm of 300 employees.

I would then assume that our testing would cost approximately $5,000 to $6,000 and perhaps more because of our complex coverages.

We have recently been provided with booklets from our dental carrier, entitled "Section 89 Survival Kit" and one from our health carrier, entitled "Your Guide to Section 89." The first booklet is only 35 pages long and provides some explanations of the testing procedures but does little to cover the law in depth.

The second booklet is 156 pages in length and has excellent examples and explanations of the discrimination testing. In the foreword to the guide, however, there are several caveats such as, and I quote, "We believe that chapters 4 and 5 can be particularly helpful to smaller employers and any others who maintain relatively uncomplicated plans."

Our agent for this company has informed us that ours is not an uncomplicated plan; therefore, the testing cannot be done by their methods and programs. It will be necessary to have to an outside consultant perform these tests at a cost running several thousand dollars.

Another caveat reads as follows, and I quote again, "Section 89 is complicated. Many of these provisions and rules of application might reasonably be interpreted in different ways."

This particular statement should scare every business and be of great concern to everyone. IRS has stated that an employer may rely on his reasonable interpretation of the statute and in its legislative history provided that such reliance is made in good faith.

Many of us know that reasonable interpretations of regulations are settled in tax courts or through lengthy and expensive arbitration proceedings. Not many small businessmen can gamble that their reasonable interpretation will stand up to IRS scrutiny several years from now. The penalties and sanctions are too severe under Section 89 both for the employer and employee to take such a gamble.

In answer to a question on how Section 89 will impact our company, I can only cite our experience with our defined benefit pension plan. Our pension plan was started in 1973, and in June of this year we applied to IRS for approval to terminate it and disburse all the funds to the employees.

Why was this done? Due to the increase in Government regulations, our plan had to be amended three times in the last six years. Each amendment costs us thousands of dollars in legal and administrative costs. Last year IRS changed some of the actuarial assumptions that could be used. This change prohibited any company contributions for 1988 and basically froze the plan.

Pension benefit guarantee corporation premiums have increased 500 percent over the past 5 years. These increases in legal, administrative, and insurance costs plus the plan freeze led us to the decision to terminate the plan.

Could this same thing happen to health and welfare plans in the future? I think that it might be easier to dissolve these plans than to live under the specter of Section 89.

Section 89 has already cost our company many hours of research and educational seminars, but the most expensive aspects of this law are yet to be felt. Changes in plan documents and employee

benefit booklets would be necessary. The testing data must be gathered and sorted into the testing components. Outside consultants would have to be paid to assure that all aspects of the law are covered.

Some time in the future Government bureaucracy will be established to monitor this law, which will in turn necessitate the completion of reporting documents by all companies.

A company our size cannot afford to have a full-time personnel manager to monitor and direct this effort. Our personnel manager is also the office manager, risk manager, tax manager, finance director, and in some cases a purchasing agent. Every employee in a small company wears many hats, and when one area consumes too much of his time the other areas suffer.

Our company cannot afford to absorb these costs in the future. It can only take the necessary steps to minimize the costs and risks such as we did with our pension plan. Five years ago if you had asked if we would ever terminate our pension plan, the answer would have been a resounding no. I hope we do not have to answer the same question regarding our health and welfare plans in their current form. We need Section 89 repealed.

Senator KASTEN. Tom, thank you very much.

Mike Engel, general counsel, Midwestern National Insurance Corp. We welcome you.

STATEMENT OF MICHAEL T. ENGEL, VICE PRESIDENT AND GENERAL COUNSEL, MIDWESTERN NATIONAL INSURANCE CORP., LA CROSSE, WI

Mr. ENGEL. Thank you. My name is Michael T. Engel, and my position is vice president and general counsel to Midwestern National Insurance Corp. My company's address is 115 Fifth Avenue South, La Crosse, WI.

Our company is a small midwestern insurance company. One of our primary insurance markets is the sale of health insurance policies to small employers around the Midwest. Most of our group health sales involve employers with 10 to 50 employees.

In our small group market we have not seen evidence of significant discrimination with employer groups. In most of our groups the employer pays the same percentage of premium for all eligible employees in the company.

A standard provision in our contract states that employees in the group are automatically covered once they work at least 30-hours per week so long as they satisfy the insurability requirements of the policy.

The 30-hour provision issues by most other insurance companies. This 30-hour provision conflicts with the 17-hour rule currently used in the Section 89 law.

For the last 2 years or so, Section 89 has caused a lot of problems and concerns to our agents, our clients and to people like me in the home office of the company. Our agents and clients have been concerned about the impact of Section 89 on their group health insurance plans that they sell or purchase through our company.

Some of our agents and clients have expected our company to provide Section 89 compliance services to go along with the Group

Health Insurance Programs without any additional cost to the agent or client. Because of the significant cost of such compliance services, we have not been in the position to absorb such huge costs.

Many of our agents and clients have looked to us for specific answers to their questions concerning the various aspects of the section 89 law. We have not been able to provide them with most of these answers because of the law's complexity.

For the last couple of years, some of our agents have avoided selling health insurance plans because of the new burdensome law that would have to be dealt with if they were to sell the group health insurance plan during this period of time.

Some employers have been discouraged from purchasing group health insurance policies or renewing their existing policies because of the extra administrative costs to comply with the Section 89 law.

Small employers do not need to be discouraged from buying Group Health Insurance coverages for their employees because of a complex law such as Section 89. The premium cost to install a plan is high enough because of high medical costs without the additional cost of complying with a complex law.

We can probably live with a more "simplified" set of discrimination rules such as those now being debated by the Senate and the House.

We think that a 50-percent contribution level is probably the right affordability level to use in a simplified law.

The plan should be allowed to exclude employees working less than 30 hours per week.

We think that 150 percent should be the percentage used in the benefits test under this simplified law. This would encourage more plans to be sold to the small groups. We also like the special small business rules for under 20 groups that is being discussed in both the Senate and the House bills.

We see no need to exclude professional organizations under these small business rules.

For Cafeteria Plans, salary reductions should be considered employer contributions if the employee has the right to take cash rather than the insurance benefit. Otherwise, the salary reduction should be considered an employee contribution.

The qualification rules of Section 89 have not gotten a lot of adverse publicity as the nondiscrimination rules have gotten; however, it should be kept in mind that these rules will also attach additional cost to an employer for adopting and maintaining a group health insurance plan. For this reason, these rules should also be kept as simple as possible.

We also think that the reduced penalties contained in the simplified laws proposed by the Senate and the House are much more appropriate than the extremely heavy penalties set forth in the original Section 89 law for noncompliance with these qualification rules.

We hope that Congress can quickly either give us a simplified law or, better yet, repeal the old law. We would all like to get this matter settled so that we can get back to our main business of providing group health insurance.

Thank you for the opportunity of letting me testify.

Senator KASTEN. Mike, I thank you for your suggestions.

You made a number of suggestions on things that would improve what we have. It is my understanding—and I believe you stated—that Section 89 be outright repealed; is that correct?

Mr. ENGEL. That is correct. I think it has already been pointed out that anytime you try to come up with a simplified version of something this complex it is probably not going to end up being simplified.

That is why we suspect, as do a lot of other people, that we are really not going to get a simplified version, but we at least do appreciate the effort that has gone into trying to get a simplified version if we cannot get it repealed.

Senator KASTEN. Let me point out that, first of all, I strongly agree that repeal is what we need to do. We do not want to reform. We want repeal.

Second, the reason that the suggestions that you are talking about have been put forward is because people realize that it is about to be repealed, and they are hoping they can hold onto just part of it.

The reason they hope to hold onto part of it, I believe, is because they are going to put all of us through Section 89 problems the exact same way they put all of us through pension problems for the last couple of years, resulting in Tom's business finally throwing up their hands and saying it is too expensive to continue to go through and deal with these changes and reinterpretations.

If we could get the right threshold percentages with the right definition of highly compensated or whatever this year, there is absolutely no guarantee that they would be right next year.

I think I can almost guarantee that something would be wrong next year based on our recent experience. That is why I feel so strongly that we have to repeal Section 89.

Tom went through some numbers in terms of how much it would cost people to go to the seminars, how much it would cost for additional employees. From your point of view, that really is not something you would be an expert at necessarily. You are providing the insurance.

Do you have any sense of what kind of additional costs this would impose on your clients?

Mr. ENGEL. Well, I think most of our clients have talked about getting compliance through software packages of various sorts or through their CPAs or their attorneys, but it seems like the cost range anywhere from $5,000 to $15,000 for that initial compliance checkout. Then the renewal checkup the following year would probably be something lower than that but still a fairly significant amount.

So that is approximately what I have been hearing.

Senator KASTEN. One of the difficulties we have had in the debates is that Treasury is looking upon this as an ability to raise revenue. They think they may be able to raise between $100 and $120 million in revenue.

Now I think they are wrong. I think that people are either going to fix their plan or drop the plans so they will not be taxed. I do

not look at Section 89 as being the great revenue increaser that they think it will be.

We are also frustrated by the other side which Tom discussed when he was talking about how much for the consultant, how much for this, the cost of going through the process. As a result of that, the Institute for Research on the Economics of Taxation did an economic survey along with the National Federation of Independent Business and a number of other groups.

This survey is included in the handouts that are available to all of you. The date is July 24, and it is from the IRET briefing, Institute for Research and Economics of Taxation.

Let us give the IRS the benefit of the doubt and say that they have $120 million coming in, and let us not charge them for the bureaucrats that they are going to have to hire to read these forms after we send them in to them, new people that are going to have to be hired at Treasury in Washington. Give them $120 million.

The survey says it is going to cost $4 billion in legal and accounting fees and fees that Tom went through in order to provide Treasury with $120 million. Even that number, as I said, is wrong.

That is the kind of tradeoff we have for America, which is just nuts. Then included on top of that is the fact that it is a disincentive for people to have health care plans when it is the national goal to have more people covered by private health care.

We have just gotten ourselves into a ridiculous posture. That is why I think it is so important that we repeal it and we do not try to work around the edges.

Tom, let me just ask you one final question. I am trying to get a sense of your industry group. They are coming up generally with the same kinds of problems that you are.

Have you discussed this with others in your industry?

Mr. KENNEDY. I guess I have not talked to any other companies specifically on this issue. There have been a couple that just say they are ignoring it, which I think is the wrong posture to take at this point. I guess it depends upon what your outside advisers are telling you.

I think they are all going to have the same problem. I think anyone that deals with as many unions and so on is going to have a complex situation. It is going to be very expensive.

Senator KASTEN. Let me thank you both for your testimony.

We will go into our final panel. Thank you for joining us here today.

Mr. CHARTER. Senator, our final panel consists of Melvyn Hoffman, an attorney from Hoffman/Addis, and June Colsch, administrative assistant from Mid-City Steel. If you would come up.

I would like to take this opportunity to thank you, Senator Kasten, for your time and effort that you are spending on this and to thank you on behalf of the business associations in Wisconsin. We all enjoy a good working relationship with you and your staff on small business issues.

We certainly know that small business in the aggregate is not very interesting or sexy; 100,000 businesses can become a lot of statistics. Individually, business is very interesting and very dynamic.

I would like to thank the individual businessowners and the professional people who have come up here to represent their clients

and their businesses to further demonstrate to us and remind us how many small businesses there are. It is really important that they are taking a half day out of their time to do this.

Senator KASTEN. Our next witness is Mr. Melvyn Hoffman of Hoffman/Addis, a law firm here in La Crosse.

STATEMENT OF MELVYN HOFFMAN, ATTORNEY, HOFFMAN/ADDIS, LA CROSSE, WI

Mr. HOFFMAN. Yes. Thank you, Senator Kasten and Director Charter. I appreciate the opportunity you are allowing me to speak today.

I am an attorney. I am a certified financial planner in La Crosse, and much of my practice involves the provision of financial planning services to small business, individuals, owners and their companies.

Part of the services include tax planning in the context of normal business operations. It is here that the tax policy surrounding Section 89 runs headlong into the effort of small business to provide adequate health insurance coverage for employees and their dependents.

First let me preface my comments by stating my belief that we are an over-regulated society. Government mandates whose goals are laudable often defeat the very purpose for which they were intended by simply failing to reasonably anticipate the practical operational effects of such programs. In my opinion, Section 89 falls squarely into that category.

Rather than focusing upon the desirability of encouraging employers to provide more uniform or more equal employment benefits in the areas of health and life insurance coverage, Section 89 in practice appears to be a hypertechnical trap for employer and employee alike where the costs, not just of compliance with the complicated tests of Section 89, but with the determination of compliance in the growing number of cases, simply outweigh the benefit of retaining such coverage.

Just as with the 1986 tax changes that divided income into portfolio, passive and earned baskets, the details of Section 89 testing are so obtuse that CPAs are having to specialize in Section 89 just to be able to comprehend the law.

On top of this, the dirth of explanatory regulations by the Internal Revenue Service makes it next to impossible to advise clients as to whether in fact they have complied with the strictures of the new law.

Plainly, the cost of compliance evaluation will stagger small business, which is already reeling from drastic increases in health insurance premiums. To exemplify but one of the perceived inequities of the operation of Section 89, one need only examine the effect on a typical family-owned business.

At least in this area I would venture to say that the majority of such business owners do not earn over $50,000 per year. Since they would certainly qualify as more than 5 percent owners of the business, however, they would qualify as highly compensated for testing purposes under Section 89.

In that regard, they would have to incur the expense of testing which is designed not to ensure that employees are receiving coverage reasonably comparable to the owners but, rather, to see whether the owners are receiving excess benefits under the employer's plan.

Thus, it is a true tax policy; that is, it is a revenue raising law. Any pretext that Section 89 is designed to provide more wide-ranging insurance coverage for employees should be dropped as being misleading.

The sanction of taxability of benefits where the complicated tests are not met belies the true motivation of Section 89, and that is a hidden tax. By testing actual coverage rather than eligibility and the relative value of benefits provided rather than their scope or quality, Congress has virtually assured itself of a ready source of tax revenue from many well intentioned employers, some of whose employees do not require the same coverage as may be offered to others.

Thus, the so-called cafeteria plans which provide greater flexibility in today's dual income mobile society are specifically targeted.

While there are many examples of the use of the Tax Code to overkill perceived abuses of tax deductions, the practical effects of Section 89 will prove and are proving to be quite bitter indeed. The hidden revenue-raising effect will be muted to some extent because the technicalities of testing for compliance and the sanctions for noncompliance are motivating small businesses to drop certain coverages altogether rather than deal with these regulations.

There is little question in the minds of businessmen that I speak with that Section 89 is a precursor to full Government mandated health care coverage for all employees. Whether or not that is so, in the interim Section 89 is having the opposite effect.

In conclusion, I believe that a society may be judged more for how its laws encourage the broad goal of providing for the general welfare of its citizens than for punishing the few who have managed through our economic system to achieve the American dream of financial success.

Since at least 1984, tax policy has consistently been aimed at these relatively few at the top of the economic letter. Our one goal of Government should be to encourage individuals and businesses to strive for success.

One of the most productive means of accomplishing success in business is to have satisfied employees. Health and life insurance coverage for employees has long been a major component of what employees have come to expect from their work environment.

Section 89 threatens these benefits. In that regard, it is counterproductive and should be repealed.

Thank you again for your time and consideration.

Senator KASTEN. Thank you for your thoughtful testimony. Thank you very much.

Our next witness is Jeanne Colsch, Mid-City Steel.

Jean.

STATEMENT OF JEANNE COLSCH, ADMINISTRATIVE ASSISTANT, MID-CITY STEEL FABRICATING

Ms. COLSCH. Thank you, Mr. Kasten. My name is Jeanne Colsch. I am here today representing Mid-City Steel Fabricating. I am pleased to have the opportunity to voice my opinion regarding Section 89.

We are a small privately-owned company employing approximately 32 people, and I would like to point out that our intention prior to Section 89 was to be fair with all the employees. The same health benefits are offered for all the employees. Because of the fact, however, that many of our employees do have other coverage through their spouses, we are considered to be discriminating. That is a real brick wall we are running into.

Our responsibilities at Mid-City Steel cover everything from general accounting through financial statements to shopping insurance and planning Christmas parties. One of those responsibilities that has become more and more overwhelming over the past few years is the administration of employee records and benefits. It takes more of my time than just about any other given task and often seems to be futile since the birth of Section 89.

My file on Section 89 continues to grow, but I am afraid that I am still very confused about what is expected of me. The code lays out an incredible maze of data gathering, tedious comparisons, and testing procedures. Unfortunately, no two experts seem to interpret the mechanics of these procedures in the same way, which leads me to feel that perhaps I am wasting my time.

The real problem, however, is that Section 89 is really part of the simplified tax law while in reality it has become so complicated that small companies like ours will actually be spending a good deal of money trying to comply with laws such as these when their initial intent was really just to be fair with their employees to begin with.

Some small companies may even feel that they will have to discontinue benefits if they cannot afford the cost of complying. Consequently, no one really benefits.

Companies that discriminate against lower paid employees regarding benefits can continue to do so by simply grossing up wages of the highly compensated. This practice will net the Government some increased revenues, but the expense involved in administering and enforcing this law will certainly eat up whatever is generated and defeat the purpose totally, which I believe you touched on just a moment ago.

This brings up a new issue, however, that I find to be particularly unsettling. This has been brought up also. The law is disguised nice as an effort on Uncle Sam's part to watch out for the benefit of the nonhighly compensated employee. Being one of those employees, even I realize that the real intention is to generate new revenues.

The law fails miserably on both counts. It is still impossible to prevent the employer from discriminating against the nonhighly compensated, plus a good deal more tax dollars have and will be spent in the administration and enforcement of such a law than could ever possibly be generated by it.

I plead with Congress to repeal this section of our tax law now before any more money is wasted by the Government and by small companies such as ours trying to comply.

Thank you.

Senator KASTEN. Thank you for your testimony.

Have you had an opportunity in working with your lawyers and accountants and others that you work with have any estimate of how much it would cost for your company of 32 employees to comply with this law?

Ms. COLSCH. We have not really gotten to that point yet. I have spent a good number of hours.

Senator KASTEN. And your file is still getting bigger?

Ms. COLSCH. Yes, it is. The real problem we run into is we do not know how to comply because we do offer the employees, everyone, the same benefit package, and because they do not all need it and take these benefits, then we are not in compliance.

Other than giving them double coverage, then I do not know how we would become compliant.

Senator KASTEN. Let me now ask you, as a financial planner I am sure you have come up with a number of cases in which entrepreneurs or plain individuals might have a second or even a third company or job or whatever that they put together. Very often the salary that they would be getting from that entrepreneurial activity would be close to nothing. In certain cases it is costing them money. They are just going to get with one or two of their friends, and they are trying to start a new business.

I was interested in earlier testimony where a person talked about the fact that he opened a grocery store in a small town in Wisconsin, and he now had three full-time employees and eight part-time employees but in the last year his income was zero. He is out there working in that grocery store for 12 hours a day for nothing, but someday he is going to make it.

In this regard you are defined in Section 89 as a "highly compensated employee" if you own 5 percent of the business. You could be losing money in the business, have no income from the business, but be defined as a highly compensated employee just because you own 5 percent.

I wonder if you could develop some of the problems or expand on some of the problems that result from this 5 percent being a definition of a highly compensated employee?

Mr. HOFFMAN. I think you have touched on one certainly by example. I do see that regularly. Many of the people that I deal with do come in for start-up purposes. We incorporate people oftentimes in what we would call incubator type situations where these people are obtaining capital from borrowed sources and do not intend or do not anticipate receiving substantial income for some period of time.

They are building a small business. They are attempting to create a product or perform a service where they will need to employ individuals and they are prepared to make a sacrifice for some period of time in not receiving the true fruits of their labors.

Under this section, as you pointed out, they will be required to satisfy the nondiscrimination test for all of the employees and incur those expenses. I see this even in my own small firm. We

have had some of our employees for years and years. They are kind of like family. I think that happens in a lot of small businesses where you know if somebody's husband or somebody's child has a particular disability or if they are in need of a particular type of a benefit.

In a lot of these small business situations you want to target help for your employees in certain areas, perhaps a dental contract or perhaps some other special type of coverage. With this Section 89 you are dissuading people and discouraging small business in particular from treating their employees better than what is required under the law.

Senator KASTEN. Let me thank you both very much for your comments.

These are the last two scheduled witnesses. Are there others in the room who would like to make a comment or testify further on Section 89?

Why not come forward, sir, and just introduce yourself. We will do this very briefly because we are a little off schedule, but we appreciate very much your coming up.

STATEMENT OF GIB CHICKEN, NEW YORK LIFE INSURANCE CO., LA CROSSE, WI

Mr. CHICKEN. Thank you, Senator Kasten, for scheduling this meeting. I am Gib Chicken. I am an agent for a number of companies, one of which is Midwestern National, in addition to Principal Mutual.

I would like to state for the record that most of these companies offer nondiscriminatory type plans. When you get to Section 89, without repeating what has been said, I suggested to some firms that they insure employees that have double coverage now.

If you know anything about stop loss, many of these firms have stop loss of $750 or $500 and $600, something like that. Many times that single premium will equal that stop loss, and they would have to incur medical expense in excess of $5,000 to $7,000 in order to hit that stop loss. So you are adding a lot of expense to people.

I did have one firm that even terminated its group, and I recommended that they do it. I was the agent. So that is one of the results of Section 89.

Essentially, I wanted to point out one other thing. Future testing could lead to many lawsuits. I at one time thought of going into testing myself, but then if there were an error in the testing my liability insurance would have to be awfully high.

That is all I have.

Senator KASTEN. Thank you. Thank you very much. You might give Rob your card so that we get the proper spelling and other information about your name for the record.

We thank you very much, and let me say thank you to all of the witnesses. We want to encourage people to pick up the information packets, the press reports and whatever is on that front table if you had not had a chance to see them.

As we said before, this is part of a series of hearings not only here but throughout the State and the country. The information

that we have received here has been particularly valuable, and I thank you all for taking the time to share with us your experience.

I am hopeful, I am optimistic, that we are going to be able to repeal Section 89 if Washington, DC could only sit here and listen to what really happens day-to-day. I think it would be a lot different.

The whole idea of this hearing is if I cannot get all of them out here, we can at least get this testimony back there. It is going to make a difference in the way that we work with our tax laws in the future and specifically Section 89.

Thank you very much. On behalf of all of us I want to thank once more the Small Business Administration and Kurt Charter for helping us with our hearing.

Thank you. The hearing is recessed.

[Whereupon, at 3:35 p.m. the hearing was recessed.]

THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE ON SMALL BUSINESS

THURSDAY, AUGUST 17, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Madison, WI.

The Committee met at 9:05 a.m. in room 421 South, Capitol Building, Hon. Robert W. Kasten, Jr. (Acting Chairman) presiding.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. I would like to call this hearing to order. And before I introduce Kurt Charter of the Wisconsin SBA, I want to thank all of you for being here and explain that this hearing is a hearing that is held jointly between the U.S. Senate Small Business Committee, of which I am a member and Rob Gifford is a staff person and Susan is one of the Court Reporters, and, also, the Wisconsin Small Business Administration, particularly the SBA Advisory Council.

And Kurt Charter, who is in charge of the SBA here in Wisconsin, is joining us. The two of us have worked these hearings together. This is the seventh of a series of eight hearings. We have been in Green Bay, Appleton, Manitowoc, Sheboygan, Eau Claire, La Crosse, and we are going to be in Milwaukee this afternoon.

The Small Business Committee, of which I am a member has had a series of hearings on Section 89 of the tax bill in Washington. But a number of us felt we needed to have more input from people that are really going to be dealing with the forms, putting together these different tests and finding out, particularly, what it means for the vast majority of businesses in Wisconsin.

Roughly 80 percent of the businesses in Wisconsin have 20 employees or less. It is unlikely that someone with a business of that size can take the time or have the money to come and testify in Washington. So what we are doing, in a sense, is bringing the Committee meeting here.

A number of my colleagues are doing exactly what I am doing this month. Republicans and Democrats are having, in their States, hearings on Section 89. So the record that we are developing here today will be included, along with the hearing record that we have already had in Washington and with the records that are being developed in a number of other States right now, as we try to determine the effect of Section 89 on what is going to happen in business.

I am going to introduce Kurt in just a moment. He will make a few remarks and Kurt, along with the Small Business Advisory Council, has helped us arrange the witnesses and the witness lists. We will try to work in panels, with two or three of you testifying at the same time and then coming back and answering a few questions and trying to develop a number of facts about the issue.

So, with that, let me introduce to you the Director of the Wisconsin Small Business Administration Office, Kurt Charter.

STATEMENT OF KURT CHARTER, DIRECTOR, STATE OF WISCONSIN SMALL BUSINESS ADMINISTRATION

Mr. CHARTER. Thank you, Senator. It certainly is a pleasure to work with you again on a small business issue and to have you here to take the testimony back to Washington.

I would like to acknowledge again the assistance of our Small Business Advisory Council in Wisconsin in letting you all know that these hearings exist. And also the Business Association, the Independent Business Association of Wisconsin, the NFIB, and the Wisconsin Association of Manufacturers and Commerce for their help on the hearings.

SBA has an advocacy role. You think of us as a lender or a long term guarantor, or the small business development center resource network for counseling and training for businessowners, and we do all of that. But we have an advocacy role which has been established by Congress, that advocacy role. And it is among other things that we should be doing this type of thing.

There are some handouts over here; the Senator's office has brought several with him, and they have handouts on Section 89. There is some testimony that was offered by our Chief Counsel of Advocacy, Frank Swain, and if you need a little more on this, please pick those up.

Again, thank you very much for coming Senator.

Today we have eight witnesses scheduled. And first, we would like to call Jim Graham, an attorney with Fitzpatrick & Roberts, and Julien Barrientos, with Barrientos & Associates, here in Madison.

If you would come up, and as you come up, if you have prepared written testimony, please give it to Sue. And if you would take a chair up here and join us.

Senator KASTEN. Let me first of all thank you each for coming to testify, and to take your time. As I said earlier, we are going to work to assess today the regulatory, the employment and the health coverage impact of Section 89. And I know this is a complex and complicated issue.

It has been interesting, as we have gone through the state to try to, first of all, get people to understand what all of it means. And it is particularly effective, frankly, when we have accountants, attorneys and consultants, all of whom stand to make money because of the complicated provisions we have put together, but notwithstanding that, a number of whom are testifying before us not even though our firm is going to make money trying to work with your regulations, we still think it is unworkable. Certain cases are going to result in people losing benefits they already have.

But let me first begin with Jim Graham from Fitzpatrick & Roberts. Jim, thank you for joining us.

STATEMENT OF JIM GRAHAM, ATTORNEY, FITZPATRICK & ROBERTS, S.C.

Mr. GRAHAM. Thank you for having me here.

First of all, the way we approached Section 89 was to let our clients know what it was all about. And their initial reaction was frustration, extreme complexity and just not understanding the law. Those that had an idea that they were discriminating in some fashion, that they were not providing the benefits to certain workers, usually called us to set up a meeting. And we did our best to explain Section 89 to them. Our clients still did not understand the law, but did understand that there is no way that they are going to try to comply with the law.

One of the biggest problems, especially, deals with part-time employees. The law defines part-time employees, currently, as an employee who normally works less than 17.5 hours a week. Most of our employers will define part-time employees as somebody who works under 30 hours a week. They just cannot see themselves giving benefits to those employees, because the cost far exceeded the tax benefit that they were receiving themselves from health benefits and group term life insurance benefits.

So, as advisors for our clients, we have to examine Section 89 from a cost standpoint. Many of our employers just simply said, well, we will pay the tax on the benefits. Someone had suggested even taking away their health benefits, because they did not want the excessive cost and unneeded cost of maintaining these plans. If they are not going to receive tax benefits for health benefits, group term life insurance benefits and so on, then a lot of clients did not have the incentive to provide benefits to their employees.

And so, I think from that standpoint, Section 89 really is not encouraging employers to cover employees who need health benefits. But rather, it may encourage them to drop these health benefits.

Senator KASTEN. Jim, thank you very much.

What I would like to do is to have each of your opening comments, and then we will, with questions and answers to both of you, kind of explore certain aspects of this.

So, our next witness is Julien Barrientos of Barrientos & Associates, an engineering firm here in Madison. Julien.

STATEMENT OF JULIEN BARRIENTOS, PRESIDENT, BARRIENTOS & ASSOCIATES

Mr. BARRIENTOS. Senator Kasten and members of the committee, I am Julien Barrientos, president of Barrientos & Associates, in Madison. And I am also president of the Small Business Consultants in the State of Wisconsin.

I will be testifying on behalf of the Wisconsin Small Business, which is an organization of engineers and architects here in the State of Wisconsin.

We understand that the intent of Section 89 of the Internal Revenue Code, is to ensure that all employees, regardless of their salary level, receive the same level of fringe benefits. This is a

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noble, laudable goal, which we strongly support. However, we strongly disagree with the methods and procedures that are being used to achieve this goal.

First, this law appears to be inscrutable; no one seems to fully understand how it operates. Consultants, accountants, lawyers, and IRS officials who have studied Section 89 are unable to provide small business with proper guidance for implementation. If this law is passed and enforced, we will be signing a contract where the scope of our obligations and liabilities are hiding in small print, impossible to read.

We do understand that we must expend considerable funds on lawyers, accountants and consultants to help us interpret the law and to administer a set of complex tests. These expenditures will definitely impact on our business costs by raising our overhead rates. Overhead costs of small business are highly sensitive to any unrecoverable expenses. This will place us at a disadvantage with respect to large firms, which can absorb these costs in some other way.

For example, large firms are already maintaining a permanent staff of lawyers and accountants who can assist with the implementation of Section 89.

We do understand that we have the option to pay taxes and eliminate all the benefits we offer. While this may be economical for some businesses, it is directly in contradiction with the intent of the law, which is to increase coverage and make the distribution of fringe benefits more equitable.

We do understand that we must pay heavy penalties that might even put us out of business, if we do not comply with the law that we, and the experts that we are forced to hire, do not understand.

From our point of view, the risk of signing a contract with unreadable conditions is too high. We do know that health insurance costs are rapidly escalating with no end in sight. It seems that this law places the health insurance cost problem on the shoulders of the private industry, when, in fact, health insurance is a national issue that requires a substantial overhaul in our social welfare legislation.

Finally, we do understand that the only virtue of this law is that it will help to reduce our national debt. While we support this goal, we do not believe that Section 89 is an effective means to this end.

Senator KASTEN. Julien, thank you very much.

Let me just put two things in perspective here. First of all, this was passed as part of the 1986 Tax Bill, and not many people paid attention to this section. It was not until they started coming out with the regulations and, most importantly, people realized what was going on. But the law was supposed to take effect January of this year, and it was not until March or April they published the regulations, May and June until they published the technical corrections.

And at that point they were supposed to be going back and people were to have been in compliance as of January. Well, there was just an uproar in the Congress, and Nick Brady, Secretary of the Treasury, simply came out with a ruling that Section 89 would not be enforced and it would not be in force during the beginning of 1989. And it delayed everything until October 1989.

Since that, the problems have gotten worse, not better, and because of the threats of repeal, a number of people on the Finance Committee and the Ways and Means Committee have been suggesting that they can fix it, that they can reform it, that somehow, if we just change a couple of things—the definition of highly compensated employee or if we change the 80 percent threshold or if we change some other issues—that it is going to be OK.

A number of us are concerned that we cannot fix it between now and October, and therefore, without a vote, both in the House Appropriations Committee and in the Senate Appropriations Committee, last month we inserted—I did it in the Senate, and someone else did it in the House—in the appropriations bill for the Treasury Department and the IRS, a line saying none of the funds in this bill, that are going to the IRS and Treasury can be used for the purposes of enforcing Section 89 during the next calendar year.

So, basically, we have now got a break at least until next October, the end of the 1990 fiscal year, before we face this question. But the government came out with these regulations and rules so late that they got everyone, Jim, as you said, confused.

So, my question to each of you is, do you think we can fix this by working and changing the thresholds? Or should we simply be for straight-out repeal and not working to fix or reform it?

Mr. GRAHAM. Well, I favor repeal, because I really do not think the law is going to accomplish what Congress wants it to accomplish here, and I do not think these rules are workable, especially for the small employers.

Julien raised one important point, that really is important in this situation: The fact that small businesses do not have consultants, accountants, and large law firms that can advise them on this law. They typically have bookkeepers and small accountants who cannot keep up on significant laws like this.

This law is very complex, and they are not going to understand it, and therefore, small businessowners are left out in the cold and could subject themselves to significant penalties. So, I really have a problem in believing that this law can be enforced as it currently exists.

Some of the proposed law changes that are currently pending are much better, much simpler. But I still think that they are not going to accomplish their intended purpose.

Senator KASTEN. Julien, is it possible to fix this, or do you favor straight repeal?

Mr. BARRIENTOS. Senator, a 2-pound document is not easy to replace with one single statement, but perhaps deserves to be responded to. I would certainly see that this law is repealed.

Senator KASTEN. There are a number of other points that we want to develop, but I think I am going to try to develop them with the remaining panels. We are going to try to stay on schedule.

Let me say thank you, Jim and Julien, both of you, for your testimony here today. And as I mentioned earlier, all this testimony will be combined in an overall set of field hearings on Section 89. And I am hopeful that the information that we are getting from you and others are going to make it possible to repeal this law.

Thank you both very much.

Kurt, who are our next witnesses?

Mr. CHARTER. Senator, we would like to present at this time Bonnie McMullin Lawton, director of human resources, Persoft, Inc., here in Madison; Mr. Charles Krombach—Charles is with the CPA firm of Ernst & Young, here in Madison; and Gervase Hephner. Mr. Hephner owns a local tavern and is also representing the Madison Tavern League.

So, if you would all come forward.

Senator KASTEN. We will begin with Bonnie McMullin Lawton, the director of human resources for Persoft. Bonnie, welcome.

STATEMENT OF BONNIE McMULLIN LAWTON, DIRECTOR, HUMAN RESOURCES, PERSOFT, INC.

Ms. LAWTON. Thank you. I am the director of human resources at a software development firm, so you can imagine that I have before me all the computing power that I could possibly need to implement this law. I only have 75 employees to account for, and I work for very progressive management structure.

But I shrink before the details of Section 89, in large part, because it is so poorly defined. Even the jargon that is used in the law is not common among the rest of my peers and colleagues in the human resources field. No one seems prepared to define for me what a plan is, whether it includes in all cases single and family coverage for health insurance or whether, in some cases, all providers are to be lumped together as a group.

What constitutes a plan, in fact, varies from one section of the law to another section of the law. Even the initial requirements, which are touted to be the easy part to comply with, are really quite bizarre.

In one interpretation, which I received in the mail from a leading national accounting firm, there is a paragraph about the legal enforceability of the plans. And I quote, "Employers will have to review common plan practices, such as how to determine whether treatment is medically necessary, which treatments will be considered experimental, and how usual and customary rates are set."

I can only barely imagine the discussion that I might have with my insurance provider on topics such as this. I do not know how I am supposed to know what is legitimately experimental, when the FDA and the University of Wisconsin cannot figure out what to do with bovine growth hormone.

My opinion on usual and customary is certain to differ from the cardiac surgeons in town. And medically necessary is an issue that the Supreme Court grapples with on a daily basis.

Madison happens to be an area filled with health insurance options. And as an employer, we provide five different options to our employees, which we are very proud of. But we now discover that we may have allowed them to discriminate against themselves, because what we are going to be tested on is not what they were offered but what they selected. So perhaps my solution is to restrict their choices, not something that I am looking forward to.

I have read a lot of documents and attended hours of seminars by experts, many of whom are here today, in support of my opinion. But the advice varies at every seminar and is often contradictory, even from these experts. As a small business person, I do not

have the luxury of devoting my energies to a time drain such as this, and I certainly do not have an in-house attorney available at my disposal.

We all, as small business people, wear a lot of hats, and our energies have to be directed toward the survival of our business. If you are sincerely interested in the benefit provisions for nonhighly compensated employees, you are going to have to make these regulations interpretable by the average citizen, because that is who is running our businesses.

And you cannot resolve serious discrimination issues, if there are some, by punishing the mass of business people who are determined to be outstanding employers. You are going to have to give us something that we can really stand behind with enthusiastic support.

Thank you.

Senator KASTEN. Thank you very much. Thank you for your testimony in terms of the—I do not know if you call it cafeteria plans, but if you wanted to talk about the cafeteria plans or the various choices of the people being made, you are exactly right.

Under certain interpretations of this law, people have discriminated against themselves, in your words, and they and their employers are going to be suffering because of the choices that they made, which, under certain circumstances, was a choice that they made in order to combine one spouse's coverage with another.

There are all sorts of reasons that people have made those choices. And that is an important point, and thank you for bringing it out.

Our next witness is Charles Krombach, representing Arthur Young, actually now, Ernst & Young. Charles, thank you for your testimony.

STATEMENT OF CHARLES KROMBACH, ATTORNEY, ERNST & YOUNG

Mr. KROMBACH. Thank you for coming out to the hinterlands and talking to us, and letting us get some feedback from you. As I see it—first of all, I will identify myself a little further.

I am an attorney with Ernst & Young, formerly Ernst & Whinny, formerly Arthur Young, and we have been involved with counseling our clients in the past several years, since Section 89 came to the fore, and came to all of our attention.

The major problem that we have is that we see a lot of confusion. We are confused, our clients are confused, and it seems that Congress is confused as to what is going on. In light of the confusion, I can offer two horror stories. In light of the professed purposes of Section 89, notwithstanding the revenue-raising portion of Section 89, is the disbursal, if you will, of benefits among the nonhighly compensated.

Well, in the response to that, two clients in the 75 to 100 employee range have decided: we are dumping our benefits. Employees are going to pay for their insurances on an after-tax basis. And as a consequence, percentage participation in plans has gone from 70 and 65 percent, down to 5 and 4 percent. And I know that you have heard a lot of these types of stories. And I know that this is a

common response in the part of a lot of employers faced with compliance.

I laud the efforts that you are making to deal with Section 89 problems. Most recently, your attachment to the amendment, restricting the use of the funds for Treasury's enforcement of Section 89, is a good shot. But it leaves us, as advisors of our clients, in a real Catch-22 position. The law is still there. And compliance is still in this system of self-enforcement, but the self-regulation that the Internal Revenue Code represents, is still there. And yet, we do not know what we are complying with exactly. And the client has the option of saying, well, they are not going to come after me, because they have no money to come after me, and so, can I thumb my nose?

As an advisor, I am not comfortable giving out that type of advice. And yet, we are still faced with the problems of just exactly what is required.

So, thank you for your efforts, and once again, thank you for the opportunity to speak.

Senator KASTEN. Thank you very much. You are exactly right. But we can only do so much, if we cannot get a vote which is why it is an issue, not unlike ten percent withholding on interest and dividends.

A kind of a deal has been struck here, with the Finance Committee and the Ways and Means Committee. And they are not allowing, particularly in the House of Representatives, a vote on straight repeal to occur. So because we cannot get around, or the people in the House cannot get around, the procedural problem with the Rules Committee and with Congressman Rostenkowski, Chairman of the Ways and Means Committee, notwithstanding the fact that over half of the Members of the House of Representatives are cosponsors of a bill to repeal.

If the vote occurs, it will be repealed. And what they are trying to do is to delay that vote and work around the edges, and then fix it. So that there will be fewer people that will vote aye, the vote to repeal, when the vote comes.

All we have done is given ourselves more time to get straight repeal. But I appreciate the difficulty you are in. You cannot advise your client to do something that is not within the law. And the law, Section 89, is on the books. It has only been delayed because of what Treasury Secretary Nick Brady has done.

Our next witness in this panel representing the Wisconsin Tavern League, is Jervis Hephner.

Mr. Hephner, welcome.

STATEMENT OF JERVIS HEPHNER, LOBBYIST, THE TAVERN LEAGUE OF WISCONSIN

Mr. HEPHNER. Thank you, Senator Kasten. I am Jervis Hephner, lobbyist for the Tavern League of Wisconsin. We have over 4,000 members, from all over the State of Wisconsin, including taverns, restaurants, nightclubs, pizza parlors, hotels, bowling alleys, resorts, and many other small businesses.

Section 89 is a particular burden for small businesses. The small operator, who together with his or her family, have struggled to

keep their business going, will find it very difficult to provide benefits to every employee.

It is extremely expensive to provide health insurance for all employees. And you should remember that many of the employees in the licensed beverage industry are part-time employees. Most small business people in our industry, will have to quit offering health insurance to any employees. If it is the goal of the Federal Government that health insurance be provided for everyone, then another method of paying for it must be found.

Most small businesses in the beverage industry, cannot afford to provide this mandated "benefit", and stay in business. And just to add a little bit to my printed statement, this is one more problem, and one more problem that may have added to this thing. Like in Green Bay, as an example, 21, this July, there are 21 less Class B establishments opening their doors.

And in Milwaukee, there are 29 less, according to a journal editorial two days ago, less Class B establishments, licensed in the city of Milwaukee. So those 50 people, who have zero employees, now, those 50 businesses have zero taxes being paid to the State or the Federal Government. And it is a concern to this industry, and I ask you to deliver this message.

Thank you very much.

Senator KASTEN. Thank you very much for your testimony. One of the things that has come up, during the hearings, is you know, the questions that you raised with regard to part-time employees. But yesterday, the head of Figi's came and testified. Their average employee group is a couple of hundred. They go to 2,900 for a certain 2 or 3 months, and then they come back.

That group of part-time people who come in for 2 or 3 months, with all sorts of unusual hours; some put 10 hours a day in every other day; some come in just for the weekends; some put 2 or 3 hours a day, early in the mornings, just to answer the phones in order to provide the orders during their peak Christmas season.

You are talking about your average tavern, with maybe 2 or 3 full-time, and half a dozen or 10 part-time. Think of what they are going through with all the unusual hours. And many of the people who are coming in, working part-time, are already covered for the rest of the year, through a spouse, or through someone else. But trying to figure out what kind of benefits they would be forced to take, and Bonnie, I can tell you are thinking, you have a good deal now with this issue.

Let me ask you, Bonnie, you got into this a little bit, in terms of the people part of this, a wide range of options right now, for a person that comes to work for you. The choice is primarily his or hers. You basically give them a booklet and explain it to them. It is probably your job to explain what the different options are. And then they make a decision. Is that right, based on their own needs for themselves and their families.

Ms. LAWTON. That is right.

Senator KASTEN. Now, Section 89 takes away a number of those options. Could you develop that a little bit for the record?

Ms. LAWTON. Well, as I understand the law, the definitions of the plans pulls all of those groups apart. And instead of looking at the total picture, the fact that everyone has the right to choose, single

or family, if they are truly a family, and choose between five different providers of health insurance, we have to break those into many different pieces and test each part individually.

That means that if just because an individual happens to be the only person in the company who wants to select a certain option, they might turn out to be a highly compensated individual, therefore that plan is discriminatory.

So it does not have any sense to it. It does not have any rationale. It is purely because someone chose an option that is different than the bulk of the people, the mass of people.

Senator KASTEN. Charlie, one of the problems with the law, and I am sure a number of your clients have dealt with this. The definition of a highly compensated employee, is defined, not by his compensation, but defined by his percent ownership of the company. A person who owns 5 percent of the company, is a highly compensated employee. Have you in your consulting work found this, what I am thinking of, is a person who maybe has a full-time job, and is an entrepreneur, he is going out there and take a risk. He is going there with a couple of his friends, and form a new company. Maybe they are going to make no income from that new company. But they are out there, trying to get started. Because they own 5 percent or more in the new company, they become a highly compensated employee in the new company. Therefore they are forced to go through the expensive tests, and bureaucracies and whatever. Have you come across any individuals where the 5-percent threshold takes somebody with maybe no income, but an income of $5,000 or $10,000, a very minimal income, and all of a sudden, he or she becomes a highly compensated employee?

Mr. KROMBACH. In response, Senator, yes. We have dealt with that issue, with quite a few clients. Particularly in the emerging business area, where we are dealing with the entrepreneurs of Wisconsin, specifically in Milwaukee and Madison areas, primarily. And quite frankly some of the best minds and some of the most time of the attorneys and the accountants are spent in trying to deal with how to dodge the percentage ownership test. So that we will not have to jeopardize the benefit plans that you have to offer, in order to be a competitive business.

If you start pulling back on offering the multiple choice health insurance benefit programs, the multiple choice day-care options, and life insurance options, and things of that nature, within your cafeteria plans, you are just not going to be a competitive employer. And investors in businesses know that, and as a consequence they really have to wrestle with whether or not they are willing to take, to take a smaller equity position in a firm, so as to insure that they will be able to attract and retain those desired and very key employees.

Senator KASTEN. The day before yesterday, we had a person who started his own grocery store, in small town, year ago. He and two full-time employees—that was three—and then they have eight part-time employees, and their community is a community of about 800 people, and he pointed out that he did not make any money, himself. The grocery store broke even.

Basically he did not have any salary or income, from the grocery store last year. And he owns a significant proportion of the grocery store, well over 5 percent.

But even if he just owned 5 percent of the grocery store, and zero income, he is a highly compensated employee, under the guidelines of Section 89. He is in the process of basically dropping the whole plan and the whole effort he is making, trying to help the people working for him.

Mr. KROMBACH. And in your scenario, Senator, I have seen many situations where about the compensation that that individual may take, would be the health insurance coverage for himself and his family, and not take any W-2 income per se. And it is, it is a real primp on business development.

Senator KASTEN. The other difficulty is, people making money in their small business. What they are choosing to do is gross up their own salary, and drop benefits for everyone. And that means, America is a net loser. Our public policy from Washington says we want more people covered under wider variety of private health care programs, in order to deal with these problems.

And what has happened is that Section 89 is a disincentive for that kind of coverage. The result is, people are dropping their plans. More people will end on Medicare and Government assistance, and we have two contrary policies coming from Washington. What we ought to be doing is putting incentives into the system for more flexibility on behalf of employers. And then at the other side what we want to do, is allow individuals, self-employed individuals to be treated as corporations so that they too can duck their health care premiums.

Those are two steps we want take that would be positive incentives, so people would be able to have more health insurance. This one is going the wrong way.

Let me say to the three of you, thank you very much. We have got one additional panel, and we are trying to do about 15 minutes each, and we will be successful then, on staying on schedule. But thank you all for your testimony here today. Kurt Charter.

Mr. CHARTER. Thank you, Senator. In the final panel, we would like to present Terry Monson—Terry is with Monson Construction Co., here in Madison. Len Linzmeier—Len is with Windsor Homes, Inc. in Madison, and John Rosenbaum of Graber Industries in Middleton. If you would all come forward, please.

Senator KASTEN. While we are getting this next panel organized, let me do two things. First of all, I would like to ask unanimous consent that a number of letters, along with some testimony from individuals, in the Madison area, be included as part of the record, at this time.

There were a number of individuals who have indicated that they would like to speak, a number of individuals who have written; we were not able to accommodate all of those. I have a group of letters and testimony, going from construction workers to Pizza Pit, to construction companies, to American Family Insurance, to two or three hospital clinics, across the gambit of the small busi-

nesses in the Madison community. And I would like for those letters and that testimony to be included as part of the record.[1]

Senator KASTEN. Let us begin this panel with Terry Monson.

STATEMENT OF TERRY MONSON, REPRESENTATIVE, THE NATIONAL ASSOCIATION OF HOME BUILDERS, INC.

Mr. MONSON. I am here, representing myself, and also, I am representing the National Association of Home Builders; I am a national representative.

Speaking for myself, and my business, we employ many college students during the summer, some of these college students are hockey players, football, what have you. The proposed bill would certainly, or Section 89 would certainly hurt that position of our company because of the part-time help we employ during the summer. And along with that, implementing the program, and the time my accountants and attorneys tell me this would take, and the cost, I dread the program.

I think in looking over the written matter, certainly my company position would be to either reduce the benefits, or to basically eliminate them entirely. In looking through some of the reports from NAHB, I want to mention to you that there is some overlapping in the code, in that the Employment Retirement Income Security Act does cover qualification requirements for employees. And here again, as I had mentioned in Section 89, we are duplicating. I guess the overall picture of it is the employment of the people that I hire during the summer in my firm which I think would drastically change.

Senator KASTEN. Thank you very much. Our next witness on this pa... ...neier, representing Windsor Homes.

STATEMENT OF LEONARD LINZMEIER, PRESIDENT, WINDSOR HOMES, INC.

Mr. LINZMEIER. My name is Len Linzmeier. I am president of Windsor Homes, Inc. I started my business in 1971. We are a manufacturing company, and a building company. I am very happy to have the opportunity to be here today to represent our company, and explain how Section 89 effects us.

First, I wanted to give you some general background. We are a small business employing 49 people directly on our payroll. We also have 15 other people working at our manufacturing facility by contract. The Federal and State law mandates have made me operate this way, in order that I may survive as a business. I like to employ students on a part-time position in the summer months. As being in the construction, that is our peak period. We also like to give opportunities to people who show talent and good work ethics, they can advance in our company.

We have had a group health insurance since 1971, whereby the company pays one third of the premium for all production workers and office workers who are hourly employees. Anyone working less than 30 hours a week, or students working in the summer, are considered part-time, and do not receive benefits. Salaried employees

[1] Material referred to appears in appendix.

receive all of premium paid, as that is part of their benefit package agreement when hired, to compensate them for the productivity and the extra working hours they perform to keep our company existing and profitable.

Some of our employees refuse health insurance for one reason or another. One is a spouse and is covered or they do not want to pay their part of it. Besides health insurance, we felt that it was necessary to cover all of our employees with short and long term disability which the company pays all of the premium. As a small business, we feel we are trying to help our people. They know the program before they start working for our company. Between Section 89 from the Federal level and State health care tax being proposed now, it would probably be best for us to discontinue all health insurance and disability benefits, and just compensate the employees for wages.

With all these mandates, one can see that the Government is leading small business to the bankruptcy court.

I would like to close with reading an article taken from the Milwaukee Magazine. William Raabe, an accountant professor at the University of Wisconsin, Milwaukee, estimates that there, "are only 35 people in the whole country who really understand Section 89." Far more people are baffled by the maze of ands, ifs, buts, and either-ors, that confounds this bill.

"It will probably take one whole person at every company, that's $20,000 to $50,000 a year, just to comply with the law," he says. "Being a benefit manager at the company now is even better than tenure at the university." I would like to just bring to you, because I think I just brought two other articles, they are in my packet up there. And I would like to read to you, coming from Brandt Thornton's magazine which arrived on my desk yesterday.

As though House and Ways and Means Committee would revise Section 89, would apply only to employer-provided health care benefits, they are saying now. The committee proposal would continue the present qualification requirements, but change the penalty for violating them. Rather than cause employees to lose the tax-free status of their benefits, the proposal would impose an excess tax on employers, the people who create the jobs.

The proposal would also change the nondiscrimination requirements; the plan would meet the requirements, if it is covers at least 90 percent of the employees, and the employer paid at least half of each covered employees cost.

If the plan failed to meet these requirements, highly compensated employees would be taxed on their coverage. Additionally, employees earning less than $20,000 per year would not be required to pay more than $1,000 year for single coverage, or $2,000 a year for family coverage. The proposal provides special rules for employers who normally have fewer than 20 employees. Although it will be several months before legislation to change Section 89 is finalized, the final version is expected to closely resemble this House and Ways Means Committee proposal.

In my packet up there, is a, for your information Senator, is a copy of my health insurance for the past 3 years. We originally have a problem just getting health insurance at a reasonable rate. Now, if we impose this upon us, our best way out is to get rid of

the premium, pay the employees, let them do what they want to do. And that is what will happen with Section 89, as far as our company is concerned.

[Material follows:]

Windsor Homes, Inc.

Health Insurance Cost Only -

	# Enrolled in 1987	per month	1988 per month	1989 per month
Single	19	$65.75	$97.69	$ 83.24
Limited Family	20	$181.94	$211.63	$242.84
Full Family	9	$181.94	$264.53	$242.84
	38			

* Current company we had to go to get coverage only has single rate and a family rate.

Company pays:

1/3 of the premium on employees

Single	$27.75
Family	80.95

Company pays entire premium for salaried people

23-617 0 - 89 - 6

For: WINDSOR HOMES, INC.

Member of: Wisconsin Builders Association

EMPLOYEE	AGE	MEDICAL	OPTION 1		OPTION 4	
A. Ballweg	47	Family	$264.83		$258.91	3,177.96 *
B. Decker	29	ES	$130.22	43.56	$127.44	
W. Fabisiak	23	Single	$ 53.25	17.73	$ 52.21	
R. Francois	39	EC	$126.35	42.07	$123.63	
P. Gilbertson	50	Single	$128.51	42.79	$125.69	
G. Green	33	Single	$ 61.48	20.47	$ 60.24	
M. Hammes	48	Family	$264.83		$258.91	3,177.96 *
M. Herrington	23	Family	$176.18	58.68	$172.37	
R. Holmes	26	Single	$ 53.25	17.73	$ 52.21	
S. Hundert	37	Family	$221.19	73.66	$216.32	
J. Jacquart	35	Single	$ 66.74		$ 65.38	800.88 *
D. Kluth	47	ES	$219.03	72.99	$214.14	
D. Lange	54	Single	$128.51	42.79	$125.69	
C. Linzmeier	53	ES	$256.92		$251.13	3,083.04 *
D. Martin	40	Family	$244.88		$239.43	2938.56 *
L. Michaelis	65	Single	$242.19	80.65	$236.73	
H. O'Kane	38	Family	$221.19	73.66	$216.32	
R. Pearson	24	Single	$ 53.25	17.73	$ 52.21	
J. Pickarts	33	Single	$ 61.48	20.47	$ 60.24	
D. Pluim	28	Single	$ 53.25	17.73	$ 52.21	
D. Roessler	58	ES	$308.30		$301.28	3679.60 *
D. Sandlan	35	Single	$ 66.74	22.22	$ 65.38	
M. Sauk	30	Family	$211.02	70.27	$206.38	
D. Tobias	33	Family	$211.02	70.27	$206.38	
B. Trieloff	33	Single	$ 61.48	20.47	$ 60.24	
C. Wrchota	25	Single	$ 83.47	27.79	$ 81.71	
J. Faga	35	Single	$ 66.74	22.22	$ 65.38	
D. Fulkerson	31	Single	$ 61.48	20.47	$ 60.24	
M. Harvey	26	Single	$ 53.25	17.73	$ 52.21	
S. Hewuse	30	Single	$ 61.48	20.47	$ 60.24	
M. Kelly	21	Single	$ 53.25	17.73	$ 52.21	
F. Thering	60	ES	$359.41	?	$351.18	4,312.96 *

95209 x 12 = 11,425.08
21,190.08
32,615.12

7 * Salary people.
23 * hourly.
10 WAICD program
7 part time -

PRESENTED BY: DENNIS (BIRKY) BIRKHOLZ JUNE 9, 1989

WINDSOR HOMES. INC. CONTINUED

EMPLOYEES	AGE	MEDICAL
B. Brodzin	47	Waived
D. Finger	28	Waived
R. Haack	44	Waived
R. Krehl	37	Waived
D. Laufenberg	32	Waived
D. Pertzborn	32	Waived
R. Weiss	38	Waived
G. Wyss	31	Waived
E. Yusas	35	Waived
R. Douglas	32	Waived

Average Rates	Option 1	Option 4
Family (8)	$ 226.89	$ 221.88
Limited Family (6)	$ 233.37	$ 228.13
Single (18)	$ 78.32	$ 76.69
TOTAL PREMIUMS -	$4.652.00	$4.524.00

Average Rates	Option 1	Option 4
Family (14)	$229.69	$224.56
Single (18)	$ 78.32	$ 76.69

PREPARED BY: DENNIS (BIRKY) BIRKHOLZ June 9, 1989

/From the Tax & Business Advisor/

Section 89 Requirements to be Postponed

House and Senate tax writers have not yet agreed about how to change the widely criticized Section 89 of the Tax Code. But there seems to be no doubt they will change it.

And with this much decided, it seems safe to conclude that no employer will be required to comply with any aspect of Section 89 this year.

The House Ways and Means Committee has agreed to postpone to Jan. 1, 1990, Section 89's effective date. Earlier Senate action also pushed the compliance dates to 1990.

Section 89, you will recall, provides qualification and nondiscrimination rules for employer-provided health, group term life plans, and certain other plans.

As the House Ways and Means Committee would revise it, Section 89 would apply only to employer-provided health care benefits.

The committee's proposal would continue the present qualification requirements, but change the penalty for violating them: rather than cause employees to lose the tax-free status of their benefits, the proposal would impose an excise tax on employers.

The proposal would also change the nondiscrimination requirements. A plan would meet the requirements if it covered at least 90 percent of employees and the employer paid at least half of each covered employee's cost. If the plan failed to meet these requirements, highly compensated employees would be taxed on their coverage.

Additionally, employees earning less than $20,000 per year could not be required to pay more than $1,000 a year for single coverage or $2,000 a year for family coverage.

The proposal provides special rules for employers who normally have fewer than 20 employees.

Although it will be several months before the legislation to change Section 89 is finalized, the final version is expected to closely resemble this House Ways and Means Committee proposal.

/From the Group Update, August 1989/

Section 89 What Should I Do Now?

By Jim Schick, J.D.

This article will explain what you need to do this summer, what you don't need to do and the status surrounding one of the most controversial bills ever passed by Congress.

Many companies are being besieged by organizations urging them to take dramatic action on this issue at a time when pragmatic, not dramatic, action is called for.

Let's look at Section 89 as it presently exists. Aside from whether it is a good or bad law, it can be simply stated as three sets of rules. They are Qualification Rules, Nondiscrimination Rules and Reporting Rules.

Of these three sets of rules, the only one of immediate importance is the qualification rules. The nondiscrimination rules and the reporting rules are certainly technically effective at this time. However, there seems to be such clear legislative sentiment that they are far too complex, that we suggest postponing completing any nondiscrimination testing until Congress concludes its redeliberation of its rules. We recommend initiating efforts on the qualification rules which we suggest will survive efforts to modify Section 89.

To comply with Section 89, all employee benefit plans must meet a number of qualification requirements. For these purposes, employee benefit plans are defined to include group-term life insurance plans and accident or health insurance plans, both type technically termed "statutory employee benefit plans."

The qualification requirements for such an employee benefit plan are as follows.

- the plan must be in writing,
- the plan must be maintained for the exclusive benefit of the employees,
- the plan must be legally enforceable,
- employees must be provided with reasonable notification of their benefits, and
- the plan must be intended to be permanent.

If these basic qualification requirements are not met, all employees must include in income the entire value of the actual employer-provided benefits they receive, subject to percentage of compensation limitations.

For 1989, the maximum penalty is limited as follows:

- 10% of compensation to $54,480
- $5,448 plus 25% of the excess over $54,480
- $19,068 plus 75% of the excess over $108,960
- $59,928 plus 100% of the excess over $163,440

Thus each employer will want to meet these rules, regardless of what decision you make later on the nondiscrimination rules. There is a moratorium on enforcement of the qualification rules until October 1, 1989.

Complying with the qualification rules involve a three-step process:

Step 1. Identify all the "plans" your company maintains and collect all documents relating to each plan.

Step 2. Review each plan to see where each plan does or does not meet the rules.

Step 3. Prepare supplemental documents and communication materials for employees to meet the requirements.

By following this sort of checklist and following up with additional documentation to meet the written document and notification requirements, you should be able to meet the qualification rules. Then you can set Section 89 aside and wait to see what happens to the nondiscrimination rules. ■

Senator KASTEN. Len, thank you. Our next and final witness on this panel is John Rosenbaum with Graber Industries.

STATEMENT OF JOHN ROSENBAUM, COMPENSATION AND BENEFITS MANAGER, GRABER INDUSTRIES

Mr. ROSENBAUM. Thank you, Senator, my name is John Rosenbaum, and I am the compensation and benefits manager for Graber Industries. We are a manufacturing company in Middleton. We have been in business for approximately 50 years. We are a bit larger than some of the companies that you have heard from today. But I think we share a lot of the same concerns with many of the companies that are represented here.

I appreciate well the complexities of Section 89. I have been kind of the point man at Graber. It is difficult to disagree with the basic tenet of Section 89. Certainly the basic tenet is that employers should offer broad-based benefits to all employees. And I sincerely think that most, if not all companies, already offer benefits in this spirit. Unfortunately, because of, I think a mis-perception in Washington about how benefits are offered, we are being forced to comply with a lot of very, very unnecessary and burdensome regulations.

To this point in time, Graber employees, including myself, have spent approximately 150-man hours and several thousand dollars, just trying to understand the law and prepare for the testing. We have not done any testing yet. I can tell you that many people, many executives and others within the organization, walk away from these meetings, just shaking their heads in frustration and anxiety. We at Graber do not expect to make any changes in our benefit programs because they are very broad-based.

I know you have heard a lot of horror stories about Section 89 in your travels around the State. I perhaps do not need to go into any more of those. You have asked, is the best option repeal, or is it change. Repeal would be ideal. That would be the ideal solution. But absent that, I do have a few comments about ways that Section 89 could be improved, and some comments and some observations.

First of all, the emphasis as mentioned earlier in Section 89, must be on the plans offered, and not on the plan selections themselves. The data collection, and the sworn statement requirements are extremely burdensome, and they are very poorly thought out. Any amendments considered at this time have to concentrate on the availability of plans, rather than the actual selections.

In Graber's case, it is possible we could be considered to have a top-heavy plan, only because many of our second and third shift employees in manufacturing are young, as mentioned earlier here. They are young and they are unmarried, consequently they select either no coverage, or perhaps a single plan. On the other hand, many of our so-called HCEs, because of their many years of service and their long climb up the career ladder—are married with families and they typically select family coverage.

Even though we offer the same options to everyone, this can result, because of the demographics involved here, in the ludicrous result of our plans being considered discriminatory, even though they are offered to everyone at the same cost across the board.

Second, I would like to make a suggestion. I know there are proposals to eliminate life insurance testing completely; those should be heartily endorsed. I am sure that you are aware that life insurance, group life insurance, is already taxed under Section 79. And life insurance should be completely dropped from Section 89.

The third point I would like to make is that I understand that there are proposals under consideration that would allow employers a so-called safe harbor, if employees are offered health coverage, at a cost of no more than X dollars, per week or per month or per year. Since medical costs vary greatly around the country, and since plan designs vary greatly from one employer to the next, a specific dollar ceiling is really not very workable. Rather if a cost ceiling must be built in, we suggest a percentage of the total cost. And given the rapidly rising cost of health care, percentage makes a lot more sense and would not need to be adjusted for future inflation.

If for some strange reason our legislators in Washington feel that a specific dollar amount is appropriate, then the employee's cost has to be indexed, and this is a very key point, has to be indexed not with the consumer price index, or with some other index tied to the overall inflation rate, but rather must be indexed to the medical component of the CPI. If it is not, what is going to happen over time is that a greater and greater portion of the cost will be shifted to employers, and employers will just cut back and reduce benefits.

Only two other points I would like to make, I guess, and that is that, Graber is really considered a perhaps a medium-sized employer, and we can really sympathize with the problems of the smaller employer, in that Section 89 will make it so difficult for the small employer, that they are going to tend to drop their benefit plans, which means that the spouse is working and larger employers will pick them up, pick up coverage at medium sized and larger employers. And more of the cost will be shifted to Government and charitable institutions. Overall, many in the benefits community just feel that Section 89 is counterproductive.

And then the last point I would like to make is that, if Congress really feels that Section 89 must be preserved in some fashion, we have to have a reasonable period of time to comply. This last year has been extremely frustrating in that we have spent hours and hours of time attempting to comply in good faith with the rules and regs, and then only to learn continually that there are more and more changes are coming, that more and more changes are being considered, and what has happened is that we have wasted many, many hours, and many, many dollars of company resources.

It has really been a circus, I think the last year. So whatever happens, we just need a reasonable period of time to comply.

Senator KASTEN. John, thank you for your thoughtful testimony, and particularly the part about the burden is going to be switching. And when you said that, there were a bunch of nods in the room, so you know, we can see that coming; we can see that happening. I am particularly pleased you are here, because of the flexible—you not only have a first, second, and third shift, but you also have a weekend shift, or 2 weekend shifts.

Mr. ROSENBAUM. That is right.

Senator KASTEN. And the kind of flexibility that you have been able to build in, particularly with your weekend shifts, which is geared toward, primarily towards students and other people who cannot work during the week. That is the kind of flexibility that Section 89 just bumps up against, and what we want to be doing is employing more people full-time and part-time, in the private sector.

Let me make two points. The first is, we have benefit rules under present law, and they work fine. Section 89 changed in a way I think is going to make discrimination more likely to occur. I think that has been pointed out today; we are going to see people dropping their plans.

The other problem is under Section 89, you are guilty until your proven innocent. And that shifts the burden of proof from where in our society it ought to be, and that is that you are innocent until you are proven guilty. And it is the job of the IRS or the Treasury to prove you guilty. It is not your job, or your lawyer's job, or your accountant's job, or your benefits plan manager's job, or your, health insurance consultant's job, to spend 5, 10, 15, whatever it is going to be, thousand dollars, in order to prove you are innocent.

You are innocent. And the studies that have been done here, indicate that there is no widespread discrimination, in any group of people, particularly not in small business.

The other point, I want to just build on what Terry said. And you talked about the costs that you have already gone through. We were frustrated because we could not develop a cost figure for how much this would cost America. Treasury and IRS say that they are going to take in $100 million to $120 million a year, in new tax revenue, as a result of Section 89. Let us give them that. And let us not even talk about the number of bureaucrats that are going to have to be hired at the IRS, in order to read the forms that we are going to put out. There is a whole new section. So it is a whole new hallway and a whole new group of people, in order to, to make sure, that you in fact, we in fact, are complying. So forget those people.

If we assume they are going to get a 120, we said how much is it going to cost Terry, Len, and John, in accounting fees, legal fees, extra people added on. What is the cost to America. A study was commissioned by an economics research group, called the Institute for Research on the Economics of Taxation. And this study is included in the briefing papers over there, dated July 24. But this is an independent group that went out and tried to find out how much it is going to cost. They took samples of larger companies, medium-size companies, smaller companies. It is going to cost $4 billion in accounting fees, legal fees, transaction costs, consulting. It is going to cost America $4 billion in order to produce, one or $120 million; $4 billion cost to America to get a $120 million and I do not even think the $120 million is right. Because you might pay the tax once, but you are either going to drop the plan, or fix the plan. You are not going to sit there and pay that tax year after year.

So, it is just a terrible, terrible loss. The other thing I want to point out, is this began as an effort to tax all benefits. That is where it's coming from. It's not coming from the idea that we want

more people covered. It began as an idea—it is a minority view right now—on the House Ways and Means Committee. The idea is that all benefits to all people under all circumstances should be taken as taxable income. That means health insurance, that means life insurance, that means the flight that the stewardess on Midwest Express gets to and from Florida, when she is on vacation, that means that the tie that we might buy at Prange's or Marshall Field's at 20 percent less because you are an employee there. Every one of these benefits everywhere in our society, they feel ought to be taxed.

This discussion was held, this part of the discussion, in the 1986 tax bill, and people said no way am I going to support that kind of an idea. And then as a kind of a back door compromise at the last minute they said, well, let us tax highly compensated people, if we can find it. And staff, you work out a way to find it. That is how we got to where we are, and that is why even Packwood, Rostenkowski, and Bentsen, are walking away from, and their mail says, I agree with you, Section 89 is bad. But then they say, we are going to work to fix it.

I do not think we can fix it. I think we have got to repeal it. And the testimony here today has been very, very helpful. And I thank you all for being here.

I just want to make an announcement. There are a number of people who have indicated that they would like to have additional comments. We have included some of the additional comments that people brought with them today, in the materials that I have already included in the record. If there are some of you that want to make additional comments, I am happy to include those comments in the record.[1] The record will stay open till the end of this week.

The other point I would touch on, although we had no representatives of local government here, or of the school district, this issue affects all employers in America, all employers in America, except churches. That means county government, the city government, the school administrator; we had the Brown County school administrator in Green Bay, for example, talk about the nightmare it is going to be for him in order to cover this.

So this is not simply a small business issue, or a business issue. It is an issue for all parts of our society. All employers except for churches fall under Section 89. The bills that will be paid for by the counties will be bills that will be passed on to the taxpayers in property taxes or whatever. So I thank you all, very very much.

Len, did you want to make one final comment, go ahead.

Mr. LINZMEIER. As I testified, I said I contract 15 employees. I want to explain why I do that. When these mandates come down to us, and we build a home, we have to add a certain amount on to that home, and that gets too costly, and thereby cannot deliver affordable housing, which the people need.

What we did is, addressed the situation in that case we addressed what the problem was, and we did something about it. And small business in order to survive have to do that. This is the only way they will survive. And why only employ 49 people; I will tell you

[1] Material referred to appears in appendix.

why. I am not afraid to tell you why. It is not your fault, but the State of Wisconsin came down with a mandate that says that we have to do certain things if you employ over 50. So I have to go to contract out, that is all I can do to survive.

Now, they have a proposal, a bill just like Section 89, which is called health and care tax, where you would pay on the first $20,000, 5 percent of that and you would have to either turn it into the State, or pay the difference of what you pay the benefits to your employee, and send the rest to the State for the other people.

It is too burdensome to handle, so what you do is get rid of all your benefits, and pay the State. And I have a suggestion for them. All we should do is all pay into the State and be treated the same as all State employees, pay the same program and at 55 we could line up and retire too, ask for our retirement at that time.

Senator KASTEN. You are going to have to work on your State legislators for that one, notwithstanding the fact that we are in the State capital.

Thank you all very, very much. This hearing is recessed.

[Whereupon, at 10:05 a.m., the Committee recessed.]

THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE ON SMALL BUSINESS

THURSDAY, AUGUST 17, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Milwaukee, WI.

The Committee met, pursuant to notice, at 2 p.m. in the Milwaukee Metropolitan Association of Commerce Board Room, 756 North Milwaukee Street, Hon. Robert W. Kasten, Jr. (Acting Chairman) presiding.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. I would like to call our hearing to order and first of all explain a little bit about how we are organized.

This set of hearings that we are having is jointly sponsored by the U.S. Senate Small Business Committee of which I am proud to be a Member, and also by the Small Business Association, and particularly, the SBA Advisory Council of Wisconsin.

We are working together and the SBA Advisory Council helped us identify witnesses, and Kurt Charter is here, and he, along with Bob Miller, have been working with us throughout this whole series of hearings. And Kurt is going to organize the witnesses and ask you to come up and testify in some kind of a logical order.

But let me just say that what we are trying to do here is to take an issue which is not well understood in Washington, and get some input from people who are going to be directly affected by it at the local level, with particular emphasis on small business; 80 percent of the businesses in Wisconsin are 20 employees or less. And it is those kinds of people to whom paperwork and excesses, like Section 89, are just absolutely impossible to deal with.

So what we have done is gone to Green Bay, Appleton, Manitowoc, Sheboygan, Eau Claire, La Crosse, Madison, and now to Milwaukee, and listen to comments from different people, from all parts of the groups affected by Section 89, as to what this is really going to mean for them.

In Green Bay, for—well, it is important to point out first of all that Section 89 is not solely a small business issue, or even a business issue.

Section 89 applies to all employers except churches. So in Brown County, for example, we had the spokesman for county government and we also had the school administrator.

So if you can imagine what you would go through with a school administrator in terms of the different kinds of people that you would be having to keep track of, going back and forth, it is just a very, very difficult problem.

We have had a lot of emphasis on small companies, tavern keepers, others, who are 10 employees or less. And half of them will be part time, in terms of trying to develop what Section 89 really means.

So today we have got a number of witnesses, and I am going to first of all thank the Small Business Administration of Wisconsin and also the, particularly, the Advisory Council for the help that they have been to us.

I forgot to say one thing. This hearing is an extension of the hearings that we have had in Washington. In other words, we, of the Small Business Committee in Washington, have had hearings there, and we have asked people to come and testify.

Frankly, it is impossible for a tavern keeper from Two Rivers or an ag co-op individual from Chippewa Falls, or whatever, to come to Washington and testify.

So this is an extension of those hearings.

Rob Gifford of my Small Business Committee staff, and Susan, who is our court reporter for the Small Business Committee are here to transcribe what is said here today and it will then be incorporated into the record that we are developing on Section 89.

Others of my colleagues on the Small Business Committee are doing the same thing. Democrats and Republicans in their States, during this month, are having groups of hearings, a number of different series of hearings on this subject, the idea being that we compile enough data and enough information as to what really happens with this law.

So I appreciate very much you all being here and particularly the help and the support of the Small Business Administration.

I see that my friend, Bob Miller, just came in. All of you have worked with Bob. He has been very, very important to having these hearings, and he and Kurt have been either taking turns, or in certain cases, both of them being there in order to, you know, to keep us working and keep the whole schedule going and their help has been invaluable, and the Wisconsin Small Business community is lucky to have both of them working for them.

Kurt, please begin with our first panel, introduce our first panel of witnesses.

STATEMENT OF KURT CHARTER, DIRECTOR, STATE OF WISCONSIN SMALL BUSINESS ADMINISTRATION

Mr. CHARTER. Thank you, Senator. It has certainly been our pleasure to try to make this work. We appreciate the interest that you have shown and the commitment that you have to small business, and to bring the Senate Small Business Committee to Wisconsin to take this testimony on this vital issue.

SBA, as you know, has an advocacy role. However, only in situations like this can we really do something that is really in the nature of what our advocacy operation is supposed to be doing, and we really appreciate your making this available.

In addition to our Advisory Council we have had some assistance from the National Federation of Independent Business, the Independent Business Association of Wisconsin, Wisconsin Association of Manufacturers and Commerce, and state-wide publication of the fact that this hearing process is going on. And, certainly, the metropolitan Milwaukee Association of Commerce here and COSBE, its small business arm, to work with small business in this community.

We have—first, we have several witnesses. We have seven scheduled witnesses. And the first two that I would like to call up are Thomas Beug and Lloyd Herrold.

Gentlemen, if you would come up.

Tom is a manufacturer's consultant, Thomas Beug and Associates. Tom is also a volunteer lecturer and seminar person for the current series that we are doing with Wisconsin Bell, all over the State.

Lloyd Herrold, an attorney and a CPA is with Gibbs, Roper, Loots and Williams, here in Milwaukee.

Gentlemen, the written testimony that you have, if you would give one to the reporter and the others, if you would make available to the ladies and gentlemen of the press that are here.

Senator KASTEN. Let me say at the outset, as you are getting organized. We are basically working to assess the regulatory impact, the employment impact, and the health coverage impacts on small business for Section 89. And it has been controversial, difficult, and complicated, above all.

And one of the things that interests me, and Lloyd, I just note attorney and CPA after your name, and there may or may not be someone of the health benefit consulting business that is going to be here today, or not, but one of the clear indications that we ought to have. That indicates that we, in Washington, have gone too far when the people who make money try to advise their clients on our complex regulations, saying the regulations have become too complex. Now that has happened in Section 89.

We have the benefit counselors, the consultants, the attorneys and the CPAs coming, and even in the smaller communities like, Manitowoc and Eau Claire, and whatever CPAs and attorneys were coming and volunteering to testify because they were so concerned about what was happening, notwithstanding the fact that this would be a full employment for accountant's bill, or a full employment for a lawyer's bill. It really should be a real indicator that we have problems when we see as many people stepping up and testifying against us who could theoretically benefit from Section 89.

The other point I want to make is that we have benefit rules under the old tax law. They worked, and not only did we change the rules, we changed the rules in a way that makes discrimination more likely to occur, in my view.

Employers are now presumed guilty until proven innocent. And the cost of proving themselves innocent through these complex series of tests is the problem.

All of us want health coverage for as many workers as possible, and all of us want maximum kinds of choice for those workers.

But the point here is that we are going to end up by taking away the choice, but more importantly, taking away the opportunity for

health coverage, because a significant number of people, particularly those with 20 employees or less, are in Wisconsin, canceling their plans. Rather than comply and work with the costs of compliance, they are simply grossing up their own salaries and the salaries of their top workers and cancelling their plans. They cannot do it any other way and it creates a major problem in terms of the goals that we have, which is what we want to be providing health care to all.

Our first witness is Mr. Lloyd Herrold, Gibbs, Roper, Loots and Williams. Lloyd, please go ahead with your testimony.

STATEMENT OF LLOYD HERROLD, ATTORNEY, GIBBS, ROBER, LOOTS AND WILLIAMS

Mr. HERROLD. Well, Senator, I was listening closely to your remarks about the lawyers and the CPAs and that very definitely is relevant. As a matter of fact, the provision is virtually incomprehensible.

This is a single code provision that runs 12 pages of relatively fine print and that has many ambiguities in it.

I was asked to prepare a statement along more general policy lines relating to the provision which is what I have done. And I have a very simple and straightforward position.

Section 89 is an example of extreme overkill. Where actual abuses were occurring, whatever actual abuses were occurring in the welfare benefit plan area, could have been corrected as you have indicated by amending pre-existing internal revenue code sections, coupled with more effective enforcement. And, therefore, Section 89 should be repealed.

As a matter of tax policy that has been accepted theory, preferential tax treatment inhibits the ability to provide low, marginal tax rates and broad tax equity.

Accordingly, in the last decade or so, the trend has been to eliminate or reduce deductions, and to limit preferential tax treatment of income items. But there are exceptions.

Preferential tax treatment has been sanctioned for health benefits on the theory that it will lead employers to provide benefits to a wider group of middle and lower-income employees.

The provision of an exclusion from income for the value of employer-provided health benefits has, in fact, contributed importantly to the adoption of health benefit plans by a vast number of employers.

No doubt there were some abuses. In recent years due to appropriations limitations and an increasingly complex code, there has been a serious erosion of the ability of the Internal Revenue Service to supervise compliance effectively.

Whatever the reasons for it, there was a perception in some quarters, as you have indicated, that the policy objectives, justifying the income exclusion, were not being achieved under the existing system.

As a result, in an attempt to fix this system, which, in reality, was working fairly well, Section 89 was enacted. And this has caused some consultants to advise smaller businesses to discontinue their health plans, which is certainly a strange outcome for a pro-

vision purportedly intended to foster broader health-insurance coverage.

The conference report accompanying the Tax Reform Act of 1986 explains that prior law drew a distinction between insured plans and self-insured plans. The rationale for the distinction was that the premium costs and underwriting considerations would tend to preclude serious abuses in the case of insured plans.

The belief was that it would be difficult to provide widely discriminating benefits within a given insured plan.

Self-insured plans lack these safeguards and were treated as discriminatory, if highly compensated employees were favored with special benefits or eligibility requirements.

For these plans, an eligibility test required the plan to benefit specified percentages or classes of employees and to provide equal benefits for both highly compensated and nonhighly compensated participants.

If the tests were failed, excess reimbursements to highly-compensated employees were taxable only to the recipients of those excess benefits.

We had a system that probably could have been expanded to cover other types of plans and could have worked.

Under Section 89 the basic plan qualification requirements enacted appear to be reasonable and do not impose too serious a burden upon the employers: These are:

That the plan be in writing;

that it be legally enforceable, that is, nondiscretionary;

that reasonable notice of the benefits be communicated to employees;

that the plan be exclusively for the benefit of the employees and their beneficiaries;

and the plan be intended to be maintained for an indefinite period of time.

Some terms may need more precise definition, but that could have been handled by a regulation or an amendment.

Those particular requirements probably are perfectly reasonable, but unfortunately, the section goes on to require an elaborate series of tests to establish that broad employee coverage is available, and that the plan does not discriminate.

All covered employees are penalized if certain of these tests are failed.

The simple fact is that many small businesses are not equipped with sufficient personnel or systems to deal with tests of this complexity. Sixty pages of regulations in very fine print have already been issued, with countless pages to follow.

Even providing simplified rules or exclusions for businesses employing less than 20 employees, fails to address the real problem.

Businesses of substantially larger size, in terms of the numbers of employees, will be required to incur substantial costs, to understand the rules, and to develop the data needed to prove that their plans would apply.

According to one commentator, and I will quote, "The cost and difficulty of amassing sufficient information to apply the rules will be staggering."

The time and systems required for compliance add nothing to productive output in the economy. To the extent that management time is diverted to compliance activities, it is unavailable to foster increased production.

There is also a negative impact on Federal revenues since the costs incurred in complying can result in tax deductions.

Any policy or societal benefit could have been achieved by modifying existing code provisions and by more effective enforcement.

Section 89 places an unwarranted burden on all businesses and an excessively onerous burden on small business. It is too complex and far-reaching to be amended successively. It should be repealed.

Senator KASTEN. Lloyd, thank you.

What I am going to ask is for Mr. Beug to go ahead with your statement and your testimony, and then we will engage in questions a little bit with both of you and then we will go to the next panel.

So Mr. Thomas Beug, a manufacturing consultant of Beug and Associates.

STATEMENT OF THOMAS BEUG, MANUFACTURING CONSULTANT, THOMAS BEUG AND ASSOCIATES

Mr. BEUG. I am Tom Beug, and we are management and marketing consultants. This is a point of clarification.

Our former president use to like to say, "If it ain't broke, don't fix it." I would like to say, if it is fatally flawed, do not fix it, throw it out.

It is amazing to me that labor and management, small business and big business should be so violently opposed to the same law, but it is absolutely beyond my comprehension that there is still talk in Congress of attempting to revise the ill-conceived Section 89.

Our core business is developing strategic plans for small- and mid-size businesses; it is invariably a fool's errand to attempt to revise an ineffective plan. This is because the base objective of the plan is either unclear or inaccurate.

Early on I had a level of concern that Section 89 was going to cause some difficulties for our clients. In order to make certain that I would be in a position to help our clients in dealing with it, I attended a seminar that purported to explain the intent of the rule.

Though I believe that I am generally able to quickly understand complex issues, I left the seminar knowing that the only real advice I could give my clients was to hire an expert to test and, if necessary, rewrite their benefit packages.

In preparation for this testimony, I polled my clients and associates. I was hopeful that I would get some helpful remarks to share with you today. The only quote that I can repeat [laughter] is from the corporate personnel director of one of my client's. Simply, she said, "Dump it." She did add that she believed, according to the law, her firm would have 247 benefit plans for their 257 employees.

In my quest for quotes, I asked my attorney for his point of view on Section 89. With his typical brevity, he said, "I have no idea."

Trying again, I called a friend who is managing partner of one of the largest law firms in the city. He indicated that he, himself, was not able to offer much in the way of helpful advice to his clients.

What concerns me, and what I believe should concern Congress is none of the small businesses that I have polled have made any real effort to comply with Section 89.

They all believe that this law is so foolish, so onerous, and I might add, so silly, that they are assuming that it will never be enforced. I am concerned because they may be wrong.

Congress should be concerned that they have passed a law that is effectively being ignored.

As a management consultant, I have learned that while it is easy to criticize, it is more important to develop recommendations.

Assuming that the intent of Section 89 is to raise revenues by taxing highly compensated individuals under company-funded insurance benefits in excess of those available to the balance of a firm's employees, I might suggest that there is a better, more efficient way.

One might be to tax all such benefits to all employees as regular income. Clearly, this defies some political realities. However, it is not without merit.

First, this method would save both companies and the IRS considerable time and money, would eliminate the need for testing and rewriting employee benefit programs, and no special training would be required of the IRS staff.

Second, it absolutely guarantees that highly and nonhighly compensated employees will be taxed on the same progressive basis.

And finally, if we assume for the purpose of this testimony, that a dollar of salary or wage costs a company the same as a dollar a benefit, it would tend to permit employees to negotiate a compensation package that is shaped in their personal benefit.

As it stands, employees tend to see improved benefits as not costing them anything in that they are not taxed. This is true, whether or not the benefit has real value to the employee.

In terms of the political realities, the sting of taxing insurance benefits could be constructively reduced by permitting employees to deduct all medical expenses, including their contribution to their insurance plan from the gross income for tax purposes.

The current way in which medical expenses may be deducted is absolutely regressive.

In conclusion, as a consultant, my only value is my professional experience and my judgment and my honest point of view in advising a client.

Please accept this testimony as good advice and repeal Section 89.

Senator KASTEN. Thank you very much.

Let me say the genesis of this is exactly as you describe. Basically, what was happening as we got, you know, in the very beginning of tax reform, it was Kemp, Kasten and Bradley Gephardt, and then it got to be Packwood and Rostenkowski, and Treasury, and everyone came in. And everyone was arguing about a number of the broader issues.

Two tax rates or one? What the rates should be, treatment of capital gains, IRAs, whatever.

There was a minority of the House, Ways and Means Committee and some of their staff, that views, and still does, believes that all benefits to all people should be taxed. That all benefits, whether they be health, life insurance, whatever, in a company should be taxed.

That the flight coupon that the Midwest Express flight attendant gets for her sister or for herself when she goes on vacation should be taxed.

That if I work at Marshall Field's, I buy a tie and I get 20 percent off if I buy it there, that that should be taxed.

That all of these benefits from everywhere to everyone should be taxed.

When that was brought up in the conference committee, that idea was absolutely rejected, as first of all, impossible to work out in terms of paperwork. And, second, it just was not what we wanted to do because we wanted to have, at least in the area of health benefits, incentives in the system so more people would be covered.

So that was rejected, and I am told that at one point they said: Well, what about areas in which there might be highly-compensated employees?

And they said: Well, if you can find, if that is really a problem, and we do not think it is, then you could a figure out a way to put it in, just put it in the report and we will work it out. And that was Section 89.

And even now, the people that were in the room, including Packwood, Bentsen, Rostenkowski, and others, are running from Section 89. They are saying: That is not what we meant.

The only question is, whether we repeal Section 89 or fix it, reform it. And one of the things that we want to talk about is whether we can repeal it or fix it.

And let me just respond to one other question, Lloyd, that you brought up, and then I want to get you involved.

The Government says that we can take in—the IRS says that they will take in between $100 and $120 million as a result of Section 89. They wanted a huge amount of money to be taxed on all benefits, but they just estimated that if they just, the higher-compensated employees, that they would take in that money and they would take in $120 million each year and it might even go up a little bit.

Give them that revenue estimate, but I want to just point out, that revenue estimate does not consider the employees that are going to have to be hired in order to read the paper work, we are going to put a whole new hallway on Treasury just for Section 89 compliance people and they have to be paid.

But the other part of that is people are not going to pay taxes, they might pay, they might get taxed once, but you are not going to pay taxes year after year. You are either going to fix your plan or drop your plan, you are not going to pay taxes on it.

So the revenue estimates clearly are wrong and they are not offset, but give them 120.

We, people who are concerned about Section 89, took an independent, outside group of economists, because in debate on the

floor, we could not answer the question of how much is it going to cost.

And by doing a detailed, economic study along with samples from small business, medium-sized, and larger business, the Institute for Research on the Economics of Taxation came out a with a report that was dated the 24th of July of this year, and it said that it is going to cost business $4 billion in accounting fees, legal fees, consulting fees and transaction costs, in order for the Federal Government to take in, in my view, at least, a questionnable $120 million.

Now, it is crazy, and that is how we have ended up.

Lloyd, with the people you have worked with and discussed this with, you have suggested that it might be possible, at least, that people would just drop their plan completely. That people would choose not to do this, and we have had a little bit of experience in this with pension plans, clearly.

That as they have gotten more complex and just more rewrites, people just cannot afford another $10,000 or $12,000 bill from their lawyers or their accountants or their management.

Can you further develop any more the concept of people, particularly smaller people, having to drop their plan?

Mr. HERROLD. Well, at this point in time, at least our clients, they are on a wait and see mode because they are hopeful that the type of hearings that you are conducting and the statements that you have made on the floor of the Senate, that you still favor outright repeal, we are hoping that that is what is going to happen and that they will not have to deal with it.

But I think that a number of them are saying, yes, we will drop the plan or try to drop it or modify it, reduce benefits or whatever it takes, in order to deal with this situation.

And it is going to continue to happen. We have not seen all the pension plans yet that are going to be discontinued because of the problems in that area.

Mr. BEUG. Realistically, I do not think small businesses or mid-size businesses, which is my client base, can actually drop an insurance program. It is too much of a benefit for the employee. So that becomes one of the sabre-rattlings that this side of the table does.

But I do not think that that, in fact, is what is going to happen. I think what, in fact, is going to happen is that the plans will be modified.

So, as you point out, there is not going to be any tax. They will be compensated in salary and not through the benefit programs.

But, realistically, to sit back and think that a small business that has been in business for awhile, can turn around to their employees and say, the Government's doing this, so go out and find your own insurance. That is not going to happen.

Groups can buy insurance cheaper than individuals can, and I think that will be maintained.

To the point on, there is one simple comment on, that it has to be written in a way that employees can understand their benefits. It is absolutely ludicrous and nonsensical, if you did a poll today of people in this room, who understands their benefit package?

One of my clients yesterday announced at a staff meeting that they were putting out a whole new benefit package, and the reason

was simply they are insured out of Missouri. Missouri has had a new regulation, so they had to rewrite the whole thing.

But I guarantee no one totally understands their benefit package. I do not believe it can happen.

Mr. HERROLD. With respect to the cost revenue benefit cost issue that you mentioned, the $120 million versus, I think you said $4 billion in cost, $4 billion in cost is going to reduce tax revenues by at least $1 billion.

Senator KASTEN. The estimate we have is $800 million, but we are right in the same ballpark.

Mr. HERROLD. It is certainly a lot more than a $120 million.

Senator KASTEN. Exactly. Let me say thank you. There are a number of other points that we want to develop, but we have three or four more panels, and we will develop these different points as we go on.

Lloyd and Thomas, thank you very much.

Kurt, how are we organized now for our next——

Mr. CHARTER. The next panel, Senator, we would like to have Robert Taylor come forward, along with Larry Winkelhake.

Larry is an independent life insurance agent and represents Milwaukee Association of Life Underwriters with 900 members.

Mr. Taylor is president of Erie Manufacturing Co. It says here they have 125 employees.

If any of you have not noticed, there are some handout materials over there, much of which is provided by the Senator's office on Section 89. It is over here, if you have not had a chance to pick it up.

Senator KASTEN. Larry, we will begin with you. If you could introduce yourself and your company and then begin with your testimony.

STATEMENT OF LARRY WINKELHAKE, INDEPENDENT LIFE INSURANCE AGENT, MILWAUKEE ASSOCIATION OF LIFE UNDERWRITERS

Mr. WINKELHAKE. Well, my name's Larry Winkelhake. I am an independent life insurance and group insurance agent on the west side of Milwaukee.

I came here originally as an observer, but it was suggested by a couple of associates that I get on the agenda to testify.

And just, basically, I think it was Nesbitt in his "Megatrends" back in 1970, he cited the total cost for just private employers in collecting income taxes at that point to be comparable to the total annual output that year of General Motors.

And I think as we approach the 90s, we are outdoing ourselves in this note.

I personally think this issue of Section 89 is kind of comparable to scratching an itch that is not there.

So, basically, today I am testifying in behalf of myself, an insurance professional for over 20 years.

In addition to my professional and educational qualifications, I currently serve as an officer for the Milwaukee Association of Life Underwriters, and I am a director for the Milwaukee Chapter of the Society of CLUs and ChFCs.

Employer-sponsored health care as we know it today was initiated in the early part of the century. The concept of pre-paid health care, as in the Blue Cross system and reimbursed health care, as in the commerical insurance system, has been essential in the development of our preventive care and medical-care systems.

It has been long held that the tax deductability to the employer and the lack of imputed constructive receipt on the employer's cost to the employee has been an important incentive for employers to sponsor such plans and employees to willingly participate in these plans.

These principles have led to the United States to become a leader in advances in health care and preventive care, while keeping the best, the cost confined to the private sector with the exception of the tax incentives to promote these essentials.

It is my belief that while implementing the provisions of Section 89, the U.S. Treasury lost sight of these basic ideals.

Section 89 in its complexity would do to the private health care system what ERISA originally did to the private pension system in 1974. Rather than promote the universal coverage of employees in this country, it would administratively force the demise of many small health plans currently affecting a substantial percentage of working Americans.

While firms employing several hundred or more employees might find it feasible to wade through the myriad of needless government regulations on this issue, the smaller employees see this as an unconscienable demand placed at a time when their efforts could better serve their customers and employees in other areas.

While I personally favor appeal of Section 89, the next best alternative to satisfy the bureaucratic desires of some of our society is the recently-approved revision by the Senate to modify Section 89.

I would suggest, however, that an employer with 40 to 50 employees would find it as much a hardship to comply as an employer with 20 employees.

I applaud you and the Senate on the attempt to modify this. Unchecked, Section 89 would have a profoundly negative impact on the countless families in this country.

Senator KASTEN. Larry, thank you very much.

Our next witness is Mr. Robert Taylor, Erie Manufacturing Co. Bob, welcome.

STATEMENT OF ROBERT TAYLOR, PRESIDENT, ERIE MANUFACTURING CO.

Mr. TAYLOR. Thank you, Senator Kasten. I want to thank you and also the Small Business Administration for giving us this opportunity to present our opinions regarding the impact of Section 89 on small business here in Wisconsin.

We appreciate the chance to be heard and hope that the addition of our voices to the hue and cry that is coming from business and labor alike will ultimately result in either the complete repeal or drastic modification of this well-intentioned but terribly misconceived measure.

U.S. Government policy has always favored private sponsorship of employee-benefit plans.

It is generally recognized, I think, that the private sector is able to provide these benefits far more efficiently than would the Government. And Congress has encouraged this practice by making them tax-deductible for business, and by making them tax-free to employees.

This practice has worked well and in general the typical American employer has taken advantage of the system to provide his employees with an ever-increasing array of benefits, ranging from health care to life insurance to retirement plans, accident and disability coverage, and so on.

The employment market itself provides a powerful incentive to provide these benefits. If for no other reason than they are becoming increasingly essential to hiring and keeping good and dedicated employees.

However, a new concern seems to have arisen in Congress that the system is not working as well as it should, and that many of our benefit plans discriminate in favor of highly compensated key employees.

The remedy to this perceived problem is Section 89, in which American employers, offenders or not, and I would suggest that the vast majority are not offenders, are being required under pressure of extremely onerous penalties in the form of excise taxes, to undergo a series of exceedingly complex tests, data-gathering, and justification simply to prove that their plans are nondiscriminatory.

All of this activity for the vast majority of employers who are in compliance is terribly costly, must be done repeatedly year after year, even when the outcome is known and obvious. But more importantly, it does nothing, absolutely nothing to benefit that firm's customers who only stand to see their prices go up to cover the costs; owners who only stand to see profits reduced by whatever portion of the added cost cannot be passed on to the customers; or employees whose benefits will not change one iota as a result, unless they are highly compensated employees, and their benefits go down.

Who benefits? No one.

In the case of the firm that is in compliance, no one benefits.

And for the firm that is not in compliance, what do we do? We collect taxes and assess penalties. To that firm's customers, owners and employees, absolutely no benefit accrues either.

But let us get back to the process of the testing itself which, for the vast majority of firms, will be going on annually for the sole purpose of proving that they are in compliance.

We have a word for such activity in the business community. It is called nonvalue added activity.

And if you read the writings of all the current business gurus, or talk to the managers of most of America's competitively-besieged businesses, we are engaged in an absolute war against nonvalue added activity.

We have learned a lesson from international competitors that we can no longer afford the luxuries of large management oversight staffs.

Corporate bureaucracy is being trimmed away rapidly and American industry is returning to the lean, mean, efficient posture that typically characterizes the small business.

Now the Congress comes along and adds, for the sake of policing just a few offenders and collecting a few added taxes, a huge dose of nonvalue-added recordkeeping activity to all of American business at the very time when we, fighting for our competitive lives, are stripping it away as fast as we can find it and reorganize to do without it.

We collectively bemoan the relative decline of American productivity versus that of our international competitors.

I can remember pronouncements from many a recent congressional candidate, to the effect that we have to restore American productivity, and yet many of these same individuals are coming down again and again on the side of increased Government control of the workplace, mandated benefits for workers, and so on.

It must be understood that these are not just minor issues or nice-to-have things; they are matters of life or death to the competitiveness of American business, especially the small business who cannot afford the luxury of a personnel staff or a legal department.

Section 89 represents an even more onerous burden because it is required of everyone in order to clean up the offenses of a few, and absolutely no one benefits from its requirements.

By definition, most of the effort is just wasted recordkeeping and unnecessary overhead. We cannot afford it; it is counter-productive.

Another equally-concerning factor is the disincentive that Section 89 provides against the introduction of new or expanded benefits by all employers.

In fact, just like ERISA, which engendered the wholesale cancellation of qualified pension plans by smaller businesses who could no longer afford the administrative burdens, Section 89 operates as a huge disincentive to providing new benefit programs.

Administrative and recordkeeping costs can only be added up on the negative side of any cost-benefit analysis.

Again I would ask, who is helped?

When we are concerned about the lack of adequate health coverage for some classes of employees, does it make any sense at all to add the disincentive of Section 89 recordkeeping to the decision-making process of the small business owner who is contemplating the addition of a medical plan? I do not think so.

Lastly, let me add that I do see the value of the intent of Section 89 that aims to assure equity in the design of benefit programs, even though it only does so by taking something away in the form of added income and excise taxes.

I am not naive enough to believe that a specific intent of the measure is not to raise needed tax revenue. In fact, if there is any benefit at all in the law as presently written, that benefit inures to the Government, in the form of added W-2 income and excise taxes.

Try as I might, I can find no benefit whatever to companies or to their employers or owners, and where I take issue is in the application of onerous and expensive reporting and recordkeeping requirements for all businesses, offenders, and nonoffenders alike, and in the unnecessary administrative burdens added thereby to an American industrial community that is engaged in a death struggle

against nonvalue-added activity. We have to find a better way. Thank you.

Senator KASTEN. Bob, thank you very much.

I would like to address this question about people dropping plans, and we have a number of people who have written me letters and another group of people who wanted to testify here today. I am going to ask that the letters and the testimony from the Milwaukee area be included as part of our record here today.

The groups go from landscaping companies to financial data services companies to two or three—this one's Aurora Health Care, and two or three health services companies, to a manufacturing company, a letter from the Milwaukee Board of Supervisors, from Tom Emmett, pointing out that this is all employers except churches. All employers except churches are covered under these onerous reporting requirements.

But we are going to make these part of the record.[1]

I know that Mr. Beug said that people are not going to be wanting to cancel their plans and he is right, but the fact is that a large number of people in Wisconsin, particularly 20 employees and less, are canceling their plans. Not because they want to, but their profit is so small and the cost of the consultants and the accountants, I mean, it just does not balance for them.

They cannot afford—particularly if half of those employees are part-time. They cannot meet the 80 percent test, they cannot meet two or three other tests, and all of a sudden they are—so they are cancelling their plans, and it is a serious problem.

You pointed out, I think, correctly, that on the one hand the policy of our Government, particularly this administration, has been more health coverage through the private sector and that is what we have been talking about for the last several years.

Here we have a disincentive, Section 89, for coverage in the private sector, and the result is more people are going to be uninsured or underinsured and end up on Medicare or other kinds of Government assistance or Government insurance.

A hospital person has pointed out to me that what that means is that the rates and everything else are going to continue to go on a smaller and smaller group of people as a larger percentage are on Medicare and Medicaid. And that group of patients are in there for pay, it is going to continue to go up because they are going to be more underinsured and uninsured.

Have you had an opportunity to estimate if Section 89 took place, how much it would cost your company in terms of accounting fees, legal fees, maybe a half of an employee who would have to administer this?

Have you gotten into that at all?

Mr. TAYLOR. I have to answer that.

We rank among those people that I think Lloyd Herrold was talking about that are just sort of closing our eyes and hoping it goes away because, quite honestly, we do not know how we are going to comply.

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[1] Material referred to appears in appendix.

I sent my secretary, who happens to also double as our personnel manager, and a half dozen other things, and this is typical of small business.

I sent my secretary to a seminar and she came back with a book that thick and the front of it was a flow chart of the decision-making process on all of the tests of Section 89.

She showed that to me and she said: How are we going to do this, and I said, I do not know, I just do not know, and I do not see how we can.

It would certainly require the addition of a vast amount of clerical effort. I do not know whether it is a half an employee or what, but the thing that bothers me most about it is that I know we are in compliance; there are some benefits that accrue to the highly-paid people in our business and they are all on the W-2 form.

If you have a company car and use it for personal use, it is on the W-2 form. If you have some other benefits, they are all on the W-2 form, because we like to do it the way it is supposed to be done.

Now we are being asked to spend, heaven knows how much, to prove what we already know and all that is just going to go into our cost base of doing business and being competitive in this world economy that has somebody else out there somewhere trying to do it better and more efficiently than we are.

Senator KASTEN. Well, the important point is that under this law you are guilty until you prove yourself innocent through a very, very costly process.

You might be able to do it but most small businesses in this State cannot do it by themselves. They are going to have to hire a lawyer and a accountant, and/or a consultant to come in and help them prove what they already know.

Mr. TAYLOR. We are going to have to do that too.

Senator KASTEN. So the outside people will come in to prove them innocent, to prove themselves innocent as opposed to generally speaking in this country, you are innocent until someone else, in this case, the IRS' responsibility is to prove that you are not in compliance, that you are not innocent.

Mr. TAYLOR. Again, I go back to Lloyd Herrold's comment where he said, "Wouldn't it be adequate just simply to tighten up the tax codes, if that is required, and then go about enforcing them." Do we have to load this huge administrative effort on all of American business or can we not just say, hey, if you get caught doing it, you are in trouble.

Mr. WINKELHAKE. I was just going to say, just the issue of developing a plan document to conform to the current statutes is horrendous; unless the insurance company you are doing business with develops one for you, you could be looking at $2,000 or $3,000 in legal fees just for the plan document and try spreading that out between three, four or five employees, even 10 employees. It is not a cost-efficient proposition and all you are doing is, you are reiterating the content of your certificate of coverage and your plan booklets to basically change it to a promise between the employer and the employee.

And what are you really accomplishing for the employee by doing that?

Senator KASTEN. The other point brought out and I do not know if either of you have a comment to this point and I do not know what kind of plans, Bob, you have, but you can be held not in compliance because of decisions that your employees make. It is not enough to offer a number of different plans. That is not enough. They have to accept the certain kinds of plans in the right percentages in order to make it through the test.

When we did this, for example, in Sheboygan, a person testified that he said, "Let us face it, if you get to work for the Kohler Company, they have what is, everyone around knows, is the Cadillac of benefit plans." And so, if you are working at the Kohler Company, your wife or your husband, whichever, your spouse is always included in their plan.

Now, then you get the second job and you are working at XYZ Plastics, there is no reason for you to double up on the coverage that you have already got through the Kohler Company and so you elect not to have coverage, but if enough of, so that it is almost as if you have got enough husbands and wives that are working for the Kohler Company, you automatically will not be in compliance if you are a 20- or 30-person small business in the neighborhood.

Mr. TAYLOR. I think that is right and there is an example that comes even closer to home. A lot of small businesses dumped qualified pension plans back when ERISA came along and they said: We cannot handle it, so they dumped their qualified pension plans and they put in things like 401(k)s.

The Tax Reform Act of 1986 came up with rules on 401(k)s that say that if the employees do not set aside a certain amount, which is a voluntary contribution on their part, that management can only set aside 2 percent more than the employees set aside, and you have totally limited the ability of a manager, let us say, in small business to set aside money for his retirement, because he does not have a pension plan and he can no longer contribute to an IRA because that was taken away too. By making him strictly dependent on the percentage of income that the rest of the people in the company are willing or can afford to set aside—it is terribly difficult——

Senator KASTEN. That is another problem for us to deal with on another day, but I understand what you are saying, it is related.

Do you want to make a final comment?

Mr. WINKELHAKE. I will just comment on the 401(k) issue. If you have a predominantly youthful selection of employees, that is a really big problem. You are at the mercy of your employees at that point.

Senator KASTEN. Let me say thanks to each of you for your help and, particularly, for your thoughtful testimony. We will have the next panel.

Mr. CHARTER. Thank you, gentlemen.

Lynette DeWitt and Georgia Thomas are our next panel, Senator. Lynette is with Hessler Assurance Designs in Milwaukee, with three employees. Georgia Thomas is the vice president. With that and other business, they have about 35 employees—maybe just in that business alone.

Georgia was White House Conference delegate, heavily involved in the Governor's Conference on Small Business, and recipient of

our Wisconsin Woman's Business Owners Advocate Award in Wisconsin. So, welcome.

Senator KASTEN. Georgia, we will begin with your testimony. Thank you for joining us.

STATEMENT OF GEORGIA THOMAS, VICE PRESIDENT, M.G.T. HOLDINGS, INC.

Ms. THOMAS. A little bit of a change in the name of the company. It is now M.G.T Holdings. I think that's fancy to make it look bigger, or something like that.

Senator Kasten, I would like to thank you for giving us the opportunity to testify about the effects of Section 89 on small business.

I am testifying about my particular problems with this tax code. We operate a company called M.G.T Holdings, Inc., which has three separate businesses: Cardinal Express, Cardinal Professional Building and Maintenance, and Cardinal Janitorial Supplies. Although I am representing my own company, I would like you to know that my concern is also felt by other businesses that I represent in my association activities.

At present, I am the State president of Wisconsin Women Entrepreneurs. I am vice president of Federal programs for the Independent Business Association, and I am on the board of directors of National Small Business United.

Because of these activities, my first reaction when I heard about Section 89 was, this is no problem because the health policy which I offer my employees is identical to the one which we, the owners or highly compensated employees have. Then I started to read and reread the regulations and became thoroughly confused.

I do understand the theory behind the tax code, preventing discrimination in employer fringe benefit plans. I applaud the efforts to eliminate discrimination, but I do not believe it is as pervasive as some think it is.

It is my understanding that the first step in compliance with Section 89 is to satisfy the qualification rules. These rules require that the employer's health and life insurance are: 1, in writing. 2, Guarantee employee rights are legally enforceable. 3, Notify employees of benefits under the plan. 4, Must be intended to be permanent.

The next step would be to identify the company's total number of plans, determine the plans' value, identify the employees participating in each plan, determine whether employees are classified as highly compensated, or nonhighly compensated.

Then, there are the eligibility and discrimination tests. These have been clearly explained by others who have testified, so I will not restate them. I certainly do not consider myself a highly compensated employee. However, according to my understanding, I am, because I own over 5 percent of the stock.

When I questioned our health insurance provider about the 17.5 hours, the initial reply was that it did not apply. When I asked them to please reread the rules, I received a letter which stated that they would offer the policy to employees who work 17.5 hours. It is difficult for me to comprehend how anyone could consider someone who works 17.5 per week as a full-time employee.

We employ between 30 to 40 people, and the second quarter of 1989, as an example, I employed 123 people, in order to keep 95 percent of the positions filled. The paperwork required by all branches of the Government keeps increasing, even after the Paperwork Reduction Act of a few years ago. And the paperwork necessary to comply with Section 89 just adds to that burden.

The penalties are even a greater nightmare, and I cannot afford the consultants or lawyers that it would take to assist me in complying with these regulations. In fact, in our particular situation, trying to find employees to fill the positions we have has become a nightmare; complying with Section 89 seems impossible.

We offer health insurance because we would like to attract employees who would stay, and I feel that health insurance is an important benefit. We hear about the great numbers of uninsured in this country, and I am sure that statistics will bear out the fact that many small business owners are uninsured themselves, because they cannot afford insurance. And I know this is the case, because we went without health insurance ourselves for over a year, because we could not afford it.

I understand also that the 25 percent deduction for health care costs for the unincorporated small business has been or is being removed. I believe this is discriminatory against the small business community, and I would appreciate anything you could do to have this reinstated.

I would like to see Section 89 repealed. However, I am a pragmatist and understand the realities of the situation, especially since the Administration does not seem to be anxious to repeal Section 89. So I ask you to do whatever you can to do to drastically reform Section 89 and make it more palatable to small business.

Some of the things I would like to see, and I know that you have been very instrumental in, is delaying the implementation at least until 1990. That employers would be considered in compliance, if they offer affordable health insurance to 80 to 90 percent of their employees. That employees must work at least 30 hours per week. That highly compensated are really highly compensated and not just the owners of the company. That harsh penalties be lessened and errors not penalized, if corrected within 6 months. That medically uninsurable would be excluded from consideration of nondiscrimination rules, because as you know, as a small business, we have to be medically underwritten or they will not get covered. For calculating value of plans when premiums are based on age, health, and so forth, average the totals. And for purposes of a written plan, that the insurance contract would be sufficient. It is hard enough to understand the language in some of them at times.

And Senator Kasten, I would again thank you and commend you for your advocacy of small business, not only on behalf of Section 89, but also in tort reform and your work on behalf of capital gains tax reduction. And I look forward to working with you on these matters.

Senator KASTEN. Georgia, thank you very much.

Lynette DeWitt, with Hessler Assurance Designs. Lynette.

STATEMENT OF LYNETTE DeWITT, ASSOCIATE, HESSLER ASSURANCE DESIGNS

Ms. DEWITT. We are an insurance agency specializing in services to small businesses, and we are a member of the Independent Business Association of Wisconsin and the Greater Milwaukee Employee Benefits Counsel.

First, I would like to thank you for giving us the opportunity to speak with you today. We are very aware of your efforts to repeal this bill, and we support you in that. We hope that repeal is indeed the result of your work. But realizing the political climate, if that is not an attainable goal, we would support you in delay or drastic simplification.

In preparation for today's meeting, I called many of our clients. So a lot of what I am going to say is—I will even use direct quotes from what they say, because we have a lot of employee benefits clients.

We believe that Section 89 was intended to equalize benefits for all employees. However, after analysis and observation, we have concluded that the sole effect has been to impute income to the highly compensated. The result is exceedingly high compliance cost for all employers, whether or not their plans favor the highly compensated. And we see, as you do, that it is a revenue-driven bill, the result of which is exactly counter to the national goal of expanding health care.

In addition, just as you said, it is a bill that assumes that the employer is guilty, and he has to take the time and money to prove his innocence.

In my research, I found out the IRS estimates business' annual reporting and recordkeeping burden will be 9 million hours. These are hours are in addition to the hours spent in learning about the law. I have here a 156-page booklet that one insurer has provided for their policyholders. Employers are expected to read this. Most of our clients have found the bill to be only barely comprehensible. They would depend on consultants, attorneys or accountants, to perform the tasks.

In an informal survey, I found that most of these professionals expect to charge an average of $1,500 for a firm of 20 employees for Section 89 testing services. Even so, the employer must accumulate the data, too, which is not readily available to most small employers.

Before testing, an employer must have a basic understanding of the law. I found some of our clients had begun preparations to do so. Time spent so far ranged from 10 hours for a firm of four employees to 50 hours for a firm of 150. This is before the actual testing has begun.

If the data given to the consultants is not accurate, the testing is in vain. It is difficult for many small employers to ever be fully sure they have done it correctly.

The costs of compliance are prohibitive. Aerial Company, in Marinette, WI, has 150 employees. They are one of our clients. They have determined their start-up cost to be approximately $10,000. That $10,000 does not produce anything. Fritz Jaeger, the president, who I talked to in preparation for this, estimates that there

are approximately 50,000 firms of 150 employees in size in this country. The start-up cost of all these companies is $500 million. Total costs for all companies in the Nation are estimated in the billions. Could not that money be better spent?

Aerial has a history of taking care of its employees. They have had a profit-sharing plan for 30 years. They provide the same benefits for all and are already in compliance. With start-up cost estimated at $10,000, and future compliance cost estimated at 20 percent of benefits costs, this large sum of money will be going to paperwork rather than to their profit-sharing contributions.

Aerial employees have spent 50 hours so far to evaluate what they should do; 50 hours just to try and interpret the law, and we have even helped them.

John Bryson, the president of Vaportek, a Milwaukee firm, feels that, and I quote, "The greatest resource the government wastes in small business is human time. And human time is the scarcest resource small business has. In terms of wasting time, Section 89 is a beauty." And Vaportek also provides equal benefits to all their employees.

The costs incurred for compliance are currently a tax-deductible expense, as was said earlier. And as such, every dollar for Section 89 spent reduces the employer's taxable net income. And it is a tax-reduction bill for the majority of profitable firms, who are already in compliance.

We find it difficult to believe that even the IRS understands the law. Under TAMRA, the Treasury Department was directed by Congress to produce proposed regulations by November 17, 1988. Proposed regulations were issued March 7, 1989, approximately 3.5 months late. We assume that the delay was due to complexity. If it is not possible for the IRS to comply in a timely fashion, how can we expect business to do so? And we can only imagine that the cost of educating IRS employees will be in the millions of taxpayer dollars.

It is our contention that this law defeats the national goal of expanding health care. Health insurance premiums have risen over 100 percent in the past 5 years. It would be easier for many small companies to eliminate their health plans entirely. The company, and this was suggested to me by one of our clients, that he might consider doing this, he could simply increase the employee's salary by a fixed amount. Then the employee can attempt to purchase an individual plan on the open market. For employees with health problems, this could prove impossible, and obviously some less-responsible individuals would take the cash and go without coverage. These individuals' medical expenses will ultimately be picked up by all of us, in one form or another.

One of my friends works for an equipment rental firm of 15 employees. He has been promised health insurance for over 9 months. His employer has not purchased coverage yet because of premium costs and because of the cost of Section 89 compliance. The firm is understaffed administratively and cannot deal with it. Most of the 15 employees are going without coverage.

The bill will severely limit or eliminate the benefits that employers are able to provide.

Fritz Jaeger, president of Aerial, says, "Section 89 superimposes a cost, with no value added. It is a tremendous case of mismanagement by Congress." Small business is the fastest growing provider of new jobs. Why put up one more roadblock that makes it more difficult for companies to provide benefits? It may better serve the national purposes to provide tax incentives.

The proposed regulations, issued March 7, make it acceptable for an employer to completely ignore the test, and simply impute income to the highly compensated. This would seem to indicate that the purpose of Section 89 is to generate tax revenues, and the goals of equitable coverage take a back seat to revenue generation. And that is—one of my clients is also considering doing that. I talked to someone this morning who told me that they are just going to forget about Section 89 and just put the health insurance premiums in everybody's W-2s, and just have all the premiums be taxable.

Smaller firms purchase coverage from multiple employer trusts set up by insurance companies. When an employer signs a subscription agreement to a trust, he agrees to abide by the contract stipulations. Most insurers will not allow a large disparity in benefits between classes of employees. To do so would allow selection against the insurance company and produce an adverse claims impact. Therefore, it is difficult for discrimination to exist in this environment.

One of the few areas we do see discrimination favoring the highly compensated is in group life insurance. However, that is already covered under Section 79. The law also does not address the need for flexibility to provide employees what they really need.

One of our clients is a real estate investment firm, and they have a part-time employee working 17.5 hours per week, but less than the 25 hours required for health insurance eligibility. She is a full-time student in a local college and, as such, is covered under her father's plan. Given the choice, she would rather have an additional 50 cents an hour than the insurance.

If this firm of four employees is forced to count her in the testing, they would be out of compliance and would need to impute income, even though no real discrimination is occurring. The managing partner of this firm says, "The law has a shotgun effect that is hurting a lot of people. In an attempt to get to the few, it causes a lot of problems to a lot of little people who are trying to do things right."

We feel that retail, fast food firms, and temporary agencies will be the hardest hit. Large chains will develop sophisticated tracking system to keep employees under 17.5 hours per week to avoid paperwork. And young people will be forced to try to coordinate two part-time jobs in order to make enough money for their education. Companies will find ways to eliminate jobs, as this law is just one more cost of having employees. Any additional cost that cannot be eliminated will be passed on to consumers.

Most of our clients feel this Section 89(k) rules, the qualification rules, are fair and will accomplish a worthwhile goal. Most companies feel that they are already in compliance and will do whatever it is necessary to fill in the missing pieces. However, we feel that the penalties imposed on the employees for the employer's failure

to comply are unreasonable and incomprehensible. It does not take much imagination to foresee a multitude of lawsuits for inclusion, where the employee incurs financial hardship that could have been averted.

Fritz Jaeger, Aerial's president, says, "I do not see where there is any gain. If the employer does not do their job, the employee would have to pay the tax. It is counterproductive to put legislation in that has no effectiveness." The law should not penalize the employee for the employer's failure to comply.

In summary, Section 89 is a costly, time-consuming, ineffective law that will seriously harm the ability of business to provide for the needs of its employees. It will limit or eliminate health insurance plans. It will slow the growth of new business, which means slowing the growth of new jobs. It will make it more difficult to provide coverage for the uninsured working people and their families. And it has already been a tremendous waste of human and economic resources, it attempts to correct the few imbalanced plans by penalizing the many which are in balance.

And I thank you for your work on this bill, and I have a whole list of people here who asked to be included in my testimony.

[Material follows:]

PEOPLE WHO SUPPORT REPEAL

Mr. John Hessler, CLU, ChFC
Hessler Assurance Designs
611 North Broadway, Suite 340
Milwaukee, WI 53202

Mr. Michael Hansen
Wisconsin Coach Lines, Inc.
901 Niagara
Waukesha, WI 53186

Mr. Thomas Czarnecki
Wisconsin Coach Lines, Inc.
901 Niagara
Waukesha, WI 53186

Mr. Michael Pjevach
Wisconsin Coach Lines, Inc.
901 Niagara
Waukesha, WI 53186

Milwaukee Investment Realty
605 North Broadway
Milwaukee, WI 53202

Mr. John Bryson
Vaportek, Inc.
W226 N6339 Village Drive
Sussex, WI 53089

Mr. Fritz Jaeger
The Aerial Company Inc.
116 Hosmer Street
Marinette, WI 54143

Mr. James P. Hagen
NOVA Technology
Nova Place
23 South Main Street
Hartford, WI 53027

Mr. John G. Lauber, CPA
Lauber & Company, Inc.
207 East Buffalo Street
Milwaukee, WI 53202

Mr. Robert J. Nolan
R. J. Nolan & Associates
5122 South 108th Street
Hales Corners, WI 53130

Mr. Ron Marszalek
Wisconsin Technical Advangage
9275 North 49th Street
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Mr. Larry Pelkofer
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Amtel Systems, Inc.
11629 West Dearbourn
Milwaukee, WI 53226

Mr. Reg Parker
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11629 West Dearbourn
Milwaukee, WI 53226

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Senator KASTEN. Thank you for your work on that testimony. That was terrific. Thank you very, very much for putting in all the time and effort that you did. It is going to be tremendously helpful to us.

Let me just respond to two things. First of all, it is very clear that the intent of this is to increase tax revenue without having to increase tax rates or to make some other change that could be seen. This is just a way of trying to increase tax revenue without getting blamed for increasing taxes. If we move the rates from 28 to 38, you know, you could see that. But if we start doing this—unfortunately, it costs $4 billion of expenses you are talking about to raise the $120 million. And you heard me say before, I do not even like that estimate.

But the emphasis here is not on equity. The emphasis here is on raising taxes. And unfortunately, the result is going to be people going without insurance, as a number of the people that you spoke to now.

And, Georgia, let me respond. I agree with you that self-employed people and individual proprietors, or what have you, particularly in Wisconsin, farmers, ought to have the same tax-deductible treatment of their health insurance, as self-employed or individuals, that a corporation or a small business has for theirs.

And I have introduced to that effect. It does not directly affect Section 89, but my legislation says that a self-employed individual can deduct his or her health care premiums in exactly the same way, that a corporation can deduct their health care premiums. So both would be before tax dollars.

Presently, as you are aware, it is after tax dollars for the self-employed person. Last week, I did not realize this was going to be related to the degree it is, I spent a lot of time working on an issue of health care in rural Wisconsin and I was going to small hospitals and clinics in the northern and western parts of the State, where they are losing physicians, and hospitals are unable to manage full-time, 24-hour a day emergency rooms. Some communities are getting down to three and two doctors. And their big problem is underinsured and uninsured people, and more and more percentage on Medicare.

One of the reasons they are uninsured and underinsured is many people who are coming from agriculture do not have the coverage, because it is an after-tax expense to those people who are individuals. It should be a deductible expense to all. And it is a separate piece of legislation which I have introduced, but it does——

Ms. THOMAS. Well, the reason I brought it up is, I understand that the Chairman of the House Ways and Means Committee was going to block it, if at all possible, because he is angry with the activity that small business has taken against Section 89. So, I really think it is great that you are doing something in the Senate about it.

Senator KASTEN. First of all, that is true. [Laughter.]

Second, right this minute, Mr. Rostenkowski is up to his ears on catastrophic, because America is up in arms about the catastrophic health package, and he is trying to block any revision of that. We are about to win on capital gains, as you have seen, because he lost

six of his troops, and we have kept all of ours in line. And so he has capital gains problems.

He has problems in this area of what the tax deductibility of health insurance ought to be, with regard to an individual. And he has also got major problems in Section 89 because now more than half of the Members of the House of Representatives have signed on the bill to repeal Section 89. And all he can do is be sure that the vote never occurs, by controlling the votes in the Rules Committee through his leadership position.

In every case, he is right now standing between the will of America and what they did in their committee. You cannot hold that. So now he is in the business of trying to play one group off another. And unfortunately for him, we are all talking to one another. And, actually, I am in two out of the four groups, anyway. I am in the capital gains group, and I am in the catastrophic group, and I am in the Section 89 group. It is happening the same way in the Senate, with Lloyd Bensten and Bob Packwood. But what we have got right here is 10 percent withholding and interest and dividends all over again, on Section 89.

People across America are understanding what is happening, not as much as they did on 10 percent withholding, because Section 89 has not been done to them yet. But if this took place, and every one of you had employee meetings this afternoon with your group and said this is now what we have to do because of what Congress did to us, there would be very few of them that would not, on their way out, say can I have the address of my Congressman.

We cannot let this happen. But we are not there yet, and I do not think we will be. As you know, these regulations, because, I think, you went through, or someone else went through, the time involved, they were supposed to come out in 1988. They did not come out until March. That was part of your testimony. And then technical corrections came after that, and the regs for the technical corrections still were not published. Anyway, we are now into June. We were supposed to have this take place January 1.

And finally, Secretary of the Treasury Brady said, stop, we are not going to enforce; we are not going to do anything at all. It will not be in place until October 1989.

That is where we are at this moment, except that, because the Finance Committee will not move and the Ways and Means Committee will not move, some of us on the Appropriations Committee have moved. And we, in both the House and the Senate, have put in a line in the money appropriated to run the Treasury Department. And it says none of the dollars appropriated in this bill can be used for the purpose of paying the Internal Revenue Service for the purposes of enforcing Section 89.

And that bill, that money, is agreed to both in the House and the Senate. And it will stay in, and when the bill passes, it means that for the next fiscal year 1990—it will begin this October and end next September. We are not going to have any money in the Treasury Department to enforce this for at least a year until this fall.

Now, that is going to give us several more months, in order to get this repeal vote. The day it occurs—I mean, the day they have a chance to vote on the Floor of the House of Representatives, they are either going to vote to repeal it or you are going to have a half

a dozen or 10 people who are going to be in big, serious trouble because they have been answering their mail. I am an author of the bill to repeal. And if somehow they are intimidated, by a dam or a bridge or some other promise somewhere else, they are going to have a tough time voting against the bill that they have sponsored. In the Senate, we have had a couple of test votes already. We have 56 or 57 people who are already on record for repeal.

So, it is just a matter of getting it worked. But Mr. Rostenkowski has several challenges before him right now.

When you are talking to some of the people, particularly, your medium-sized clients, do you have any way of saying how much it would cost for them to comply? In other words, a seminar cost, maybe a couple hundred dollars. We have seen that particular document, in two or three different hearings, and we even had one person say it might not be so complicated, but that, if I remember correctly, is 156 pages. That was in Eau Claire, I think, and maybe in Manitowoc.

But do you have any sense of how much it is going to cost for people to make it through the same question that I asked Bob Taylor before?

Ms. DEWITT. Yes, I do. Fritz Jaeger said that it would be, $10,000, just start-up cost for 150 employees, just to do the analysis.

One of the firms we work with as kind of a compatriot firm—they do this benefit work—charges $50 to $100 an hour, and I did some surveys to some other companies. They estimated it to be about $1,500 for a company of 20 employees. And it escalates, the more employees you have.

The problem really is, though, you have to collect so much data. I do not know if you have had a chance to look at this book; but it is a form that explains—it has a lot of initials in it, NHCE and all that kind of stuff. Principle Mutual has done an extremely good job of putting this together. There is no other insurance company that I am aware of that is supporting small business, in that they have put together a booklet to help you do it, at least providing the information. If you fill out this booklet, Principle Mutual will do the testing for you, at least they used to for $25. But the trouble is that the employer, the managing partner in my real estate firm who gave this to me, he spent 10 hours already. I do not know how much more he would have to spend.

Senator KASTEN. What page is he on so far?

Ms. DEWITT. Really, that's about it. He made about five phone calls. Principle is also supporting them. They have a toll-free phone number. You can call up and ask some expert in their insurance company what NCHSC means and all that kind of stuff, all these initials. He has done a lot of phone calling. He has called me, and we would get in conference calls. I spent a lot of time, just because he is a client of ours—we try to help him out. I keep telling him, do not worry about it, but he is kind of like an overachiever. Because it is a little premature; it might get repealed, hopefully.

I think it is going to cost employers a lot of money. I am thinking of thousands of dollars, at least. I mean it would just cost $1,500 just to have somebody do the test, you know, depending on where they go. If they go to a consultant that does it, then it is not so expensive. If you go to an accountant or an attorney, they

charge $100 or $200 an hour. It really depends. But $10,000 is Fritz Jaeger's estimate, and he and his comptroller tell me that. So I think that is fairly accurate.

Senator KASTEN. Thank you both, Georgia and Lynett. Thank you for your testimony.

It is my understanding there are one or two more people. Thank you very much.

Mr. CHARTER. Our final panel consists of Nick Lascari. Nick also carries many credentials as a small business advocate, White House Conference on Small Business delegate, the Steering Committee—the Planning Committee for the Governor's Conference on Small Business. He wandered around the state, much as we have done this week, helping SBA explain to CPAs that small business programs actually make sense sometimes. And so he has been a close friend of ours. I want to welcome him, and look forward to hearing his testimony.

Since he is the last witness, this has, for me personally, been an exciting and educational and stimulating week. And I look forward to working with you, Senator Kasten, on the next issue, and to quickly hearing that this one is history.

Senator KASTEN. Nick, welcome. Thank you for being here. Go ahead with the testimony.

STATEMENT OF NICHOLAS LASCARI, CPA, TREASURER, INDEPENDENT BUSINESS ASSOCIATION OF WISCONSIN

Mr. LASCARI. Thank you Senator Kasten. I guess thank yous go all the way around today, in the many areas I do and have represented. Today I am here as treasurer of the Independent Business Association of Wisconsin, and we thank you for your continued efforts on behalf of small business to, in addition to all other matters, try to repeal this bill. We certainly would like to see that come to pass and wish you best efforts in that effort.

I also should thank you, I suppose, as a former member of the public accounting field, because I recently retired as a tax partner from a CPA firm, after almost 20 years, and I must be crazy, because now that Section 89 is about to become law, that is probably where I should have concentrated my efforts. Perhaps I am a masochist, because instead of staying in public accounting, I decided to go into small business and subject myself to Section 89 instead.

Rather than reading the prepared testimony I have in total, it may be good to point to a few things and highlight a few areas in there. And I know your concern is seeing examples, and one that comes to mind begins on page 4 of my testimony at the bottom, and a firm I am very familiar with. Prior to 1989, it sponsored a health insurance plan for all of its full-time employees. It paid one-half of the monthly premiums for its professional staff and clerical employees, and all the premium for those in management.

They considered the plan fair because management-level employees had achieved their status through hard work, professional growth, and were, therefore, entitled to a little better benefit than those who were striving to achieve that status. The objective was not to deny benefits to staff employees, but to recognize achievement for management-level employees. Then Section 89 was en-

acted. In their case it appeared that management level employees would be reporting additional compensation income. Perhaps. The plan would need to be tested for discrimination, and with over 40 covered employees, it may have been possible to remain qualified without additional compensation income.

But the testing would have required additional time and resources on an annual basis, just to prove a nontaxable benefit was available to all employees and, if not, then to determine the level of additional compensation income for the management-level employees. This use of resources to test plan compliance was not practical, so they chose instead to continue the availability of the health insurance plan, but not to fund the plan to the same extent. In other words, they wanted to avoid any Section 89 interference.

So they decided to organize a cafeteria plan under Internal Revenue Code, Section 125. Now, rather than paying the entire cost of insurance for management-level employees and half the cost for all others, they paid the same cost for all employees. But they limited it to $400 per year per employee. So all employees were treated equally. Therefore they avoided the Section 89 testing. But, instead of the lower-compensated employee, who was on the family plan, paying one-half and the firm paying one-half of the approximate $3,000 annual premium, with the employee paying the balance—the employee now paid $2,600 of that annual premium, and the firm paid $400.

Well, to be fair, they made an adjustment, increasing staff compensation levels to absorb some of that cost increase. They were not required to do it, but they did. But I will guarantee you, it was not $2,600. As a result, the employees saw a decline in their tax-free health insurance benefits, an increase in costs and a lower benefit received from the firm. And that was mainly attributable to Section 89.

Other recent client cases: My clients decided not to pursue Section 89 testing and instead elected to tax all employees, or the highly compensated employees, on the benefits provided. Section 89 was avoided again, but at what cost? Now all the employees have additional taxable income. Oh, that increases tax revenues for the Government, but it in no way provides comparable benefits than what was previously realized.

Effectively, the lower-compensated employee is paying a higher toll to realize these same benefits as a percentage of compensation than was previously realized. I do not think that that is the effect that Congress wanted to see.

Still other clients have decided to drop their offering of health and group life insurance benefits. Now, this is normally not the case in a union-negotiating environment, because health and life and pension coverage is part of every union-negotiated benefits package. The impact of elimination of the health and other insurance benefit coverage for nonunion clients is on the not-so-highly compensated employees. Here, those employees have to seek to fill the void created by purchasing products with after-tax dollars, rather than having that benefit provided by the employer with pre-tax dollars.

I know of instances that, because of the after-tax cost associated with coverage of health insurance individually, an employee will

refuse health insurance coverage and attempt to self insure. This happened in the firm that I cited as an example, and this can have a serious ramification, which I am sure Congress did not foresee.

Other witnesses have talked about the effect. And some of what you have seen attached to my testimony are a couple of pages that I made copies of from the September/October edition of the Financial Manager, with some interesting footnotes and advertisements in them.

There was a survey conducted by Coopers & Lybrand, one of the Big-Eight firms, that contacted companies with 1,000 or more employees. And their survey reported that the most popular approaches among respondents for correcting noncompliance in the Section 89 area are reporting imputed income for affected highly compensated employees; 66 percent said they were going to do that. Or both reporting imputing income and raising salaries of the affected highly compensated employees; 40 percent of the respondents said they were going to do that.

Some other remedial compliance methods planned are reducing benefits for highly compensated employees; those were 13 percent. Increasing the benefits for nonhighly compensated employees—only 5 percent of the respondents. Was not that the target of the law? Reducing contributions for nonhighly compensated employees, 4 percent of the respondents said they would do that. And increasing contributions for highly compensated employees, 11 percent said they were going to that.

Surprisingly, or perhaps not so surprisingly, 78 percent of the companies reported that their systems could not accurately track the data needed for Section 89 testing. Only 9 percent of those people said that their systems were accurate or somewhat accurate. So what do they do? They consult accountants and attorneys. And that is where the thanks came from originally, from that profession, but I think the law needs to be repealed.

The last page that is attached to my testimony is an example of some of the costs that people are looking at to try to comply with these laws. There are software programs available. They are touted at anywhere from $395, to a CPA firm out of Kansas City which is willing to sell you the whole analyzer package, and mind you, this is just the software, for $4,950.

So, Mr. Taylor said that nobody benefits from this, I think there will be some people who do do benefit from Section 89. [Laughter]

Unfortunately, I think employees of companies in small and large businesses, and I think small business itself, are not the beneficiaries of Section 89.

I think it should be repealed. We appreciate your efforts in trying to do that. We wish you success. And if there is anything we can do, or any questions that your staff has for me, perhaps after today, I would be more than happy to help.

[The prepared statement of Mr. Lascari follows:]

STATEMENT OF

NICHOLAS S. LASCARI, CPA
TREASURER, INDEPENDENT BUSINESS ASSOCIATION -WISCONSIN

BEFORE U.S. SENATOR ROBERT W. KASTEN, JR.

Concerning Section 89 of the Internal Revenue Code

August 17, 1989

Nicholas S. Lascari, CPA
7728 Geralayne Drive
Wauwatosa, Wisconsin 53213
(414)453-2413

Senator Kasten:

Thank you for the opportunity to present the feelings of small business on Internal Revenue Code Section 89. Your concern about the impact of Section 89 on small business is well founded.

My name is Nicholas S. Lascari. I am a certified public accountant who, until recently, was a tax practitioner for almost twenty years with a large, local CPA firm. I was a partner responsible for providing tax consultation to over 150 small businesses, ranging in size from one to hundreds of employees. I am also Treasurer of the Independent Business Association of Wisconsin (IBA), a small business organization which is itself a member of National Small Business United (NSBU), a national coalition of small business organizations. IBA represents over 400 small business in Wisconsin, with a total employment of over 4,000. I also serve as a member of the Small Business Administration (SBA) Region V Advisory Council. While I am not here to speak on behalf of NSBU or SBA, I can share with you very strong sentiments about Section 89 from each of these groups.

There is no need to repeat the history of Section 89 and the reasons it became part of the Internal Revenue Code of 1986. The intention of ensuring

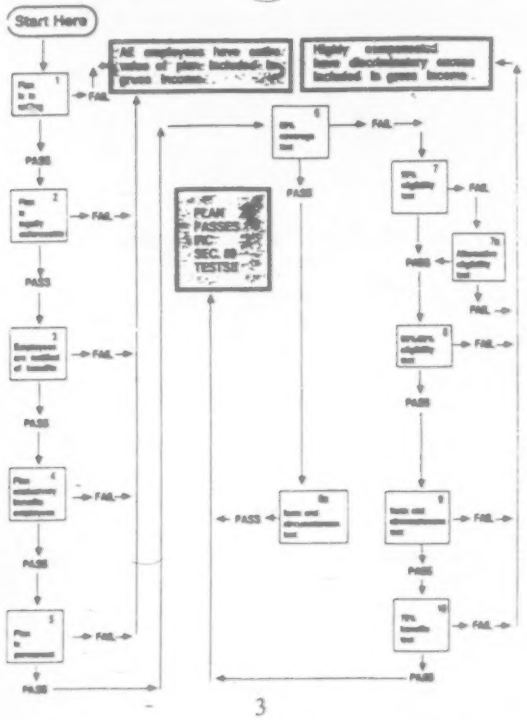
comparable benefits in health and life insurance coverage for all working Americans is laudable. Small business shares Congress' concern that the tax code provides opportunities for discriminating against those who may need health coverage the most. Section 89 is not the vehicle by which those abuses will be corrected. Instead, the opposite result is more likely - that employers will cancel health coverage altogether, due to the burden of Section 89.

You have seen an outpouring of sympathy for repeal of Section 89. You have sponsored at least two bills for repeal in the Senate, and you are committed to bringing "bad law" to an end. I support your effort. A number of Congressional leaders have sponsored repeal bills, but Section 89 is still law. Its effective date has now been delayed to October 1, 1989. In addition, many of your colleagues have sponsored bills aimed at reforming some of the worst provisions of Section 89. In the past few months, I have received correspondence from other members of the Wisconsin Congressional delegation, indicating concern about the far-reaching ramifications of Section 89. Some support reform, others repeal. It seems that Congress is in a quandry over the fate of Section 89, but is leaning toward reform rather than repeal. I believe that would be a mistake.

You are aware of the statutory requirements imposed on employee benefit plans, so I need not review the esoteric details of the law here. The main purpose of Section 89 is to tax the benefits of "highly compensated employees" who receive

discriminatory benefits when compared to other employees. To avoid taxability to participants, a plan must meet qualification, eligibility and benefit requirements. Small business believes the qualification requirements are fair, merely extending to health and benefit plans the qualification requirements for retirement plans established with the Employee Retirement and Income Security Act of 1974 (ERISA). But the attempt to extend the ERISA requirements to the discrimination rules is where employers will be frustated with their complexity and the costs to test compliance to avoid taxability. The following "simple" flow chart was developed by Charles D. Sprenger & Associates, Inc. and appeared in the November, 1987 Employee Benefit Plan Review:

Steps For Passing Health Plan Nondiscrimination Rules



As you can see, even a "simple" path is complicated by "road construction". The number of pass/fail tests that must be conducted just to prove nondiscrimination has resulted in significantly higher administrative costs and professional fees incurred by business, many of whom were already in compliance with Section 89, but were required to perform the tests to document their compliance. To hire outside consultants to perform the tests can result in additional costs of $2,000 per test and up. At my former firm, we were anticipating a significant revenue contribution from clients who were required to perform the Section 89 tests. Even those clients who have internal administrative personnel capable of performing the tests, find they will need to spend money for consultants who are familiar with the details of Section 89, because the regulations just issued by the Internal Revenue Service are cumbersome and complicated. But let me relate the practical impact of the law, not the litany of the technical attributes of the statute.

Prior to 1989, one firm sponsored a health insurance plan for all full time employees. It paid one half of the monthly premiums for professional staff and clerical employees, and all the premium for those in management. They considered the plan fair because management level employees had achieved their status through hard work and professional growth, and were therefore entitled to a better benefit than those who were still striving to achieve that status. The

objective was not to deny benefits to staff employees but to recognize achievement for management level employees. Then Section 89 was enacted.

In their case, it appeared that management level employees would be reporting additional compensation income...perhaps. The plan would need to be tested for discrimination, and, with over forty covered employees, it may have been possible to remain qualified without additional compensation income. But the testing would have required additional time and resources on an annual basis, just to prove a nontaxable benefit was available to all employees, and if not, then to determine the level of additional compensation income for the management level employees. This use of resources to test plan compliance was not practical, so they chose instead to continue the availibility of the health insurance plan, but not to fund the plan to the same extent. In other words, they wanted to avoid any Section 89 interference. They decided to organize a cafeteria plan under Internal Revenue Code Section 125. Now, rather than paying for the entire cost of insurance for the management level employees, and half the cost for all others, they paid the same cost for all employees, limited to $400 per year per employee. All employees were treated equally, thereby avoiding Section 89 testing. However, instead of the lower compensated employee who was on the family plan paying one-half of the approximate $3,000 annual premium, and the firm absorbing the balance, the employee now pays for $2,600 of the annual premium and the firm pays $400. To be fair, they made an adjustment increasing the staff compensation levels to absorb some of the cost increase. They were not required

to do this, but they did...at much less than $2,600! As a result, the employees saw a decline in their tax free health insurance benefits, an increase in costs, and a lower benefit received from the firm...mainly attributable to Section 89.

In other cases, my clients decided not to pursue Section 89 testing, and instead elected to tax all employees on the total benefits provided. In this manner Section 89 testing was also avoided, but at what cost? Now all of their employees have additional taxable income, which increases tax revenues for the government, but in no way provides comparable benefits than what was previously realized. Effectively the lower compensated employee is paying a higher toll to realize these benefits, as a percentage of compensation, than they previously realized. This is, I believe, completely opposite the effect Congress was hoping to achieve when Section 89 was enacted.

Still other clients have decided to drop their offering of health and group life insurance plans. This is not the case in a union-negotiated environment, because health and life and pension coverage is part of every union-negotiated benefits package. The impact of elimination of health and other insurance benefit coverage for these non-unionized clients is on the not-so-highly compensated employees. Here those employees must seek to fill the void created by purchasing products with after-tax dollars, rather than have the benefit provided

purchasing products with after-tax dollars, rather than have the benefit provided by the employer with pre-tax dollars. I know of instances that, because of the after-tax cost associated with coverage for health insurance individually, an employee will refuse health insurance and attempt to self-insure. This happened in our firm as well. We all know what a serious ramification this can be. Again, Congress did not foresee this result.

To circumvent some of these pitfalls and to provide small business with the flexibility to provide benefits to their employees, certain changes have been proposed to ease the administration and compliance burden of Section 89 for small business. Sweeping reforms have been agreed to by the House Ways and Means Committee, in an effort to bring some reason to the administration of Section 89. These reforms include provisions which would allow employees to pay up to 50% of their own premiums, although 90% of total employees must still be covered under the plan, provided that the total employee contribution is no more than $1,000 per year for single coverage and $2,000 per year for dependent coverage, for those employees earning less than $20,000 per year. A new simplified testing would allow a maximum benefit of 150% of the average benefit for all employees. These changes are in addition to those already proposed by Chairman Rostenkowsi in the House Ways and Means Committee markup on H.R.1864. In addition, Senator Bentsen has introduced similar legislation for Section 89 reform in the Senate Finance Committee as S.1129. Both these measures are a good start at modifying a law that should never have been

enacted.

We must seek alternatives to accomplishing the agenda of providing nondiscriminatory health and life insurance benefits to working Americans. But to accomplish this goal, we must seek other avenues than the complicated and confusing statute we now have in Section 89. Before allowing Section 89 to become law, we should repeal the measure and start over. Lacking that as a viable alternative, you can feel confident that your small business constituents favor the reform proposals now contemplated by Chairman Rostenkowski and the House Committee on Ways and Means.

Thank you again for the support you have given small business on this vital issue, and for the concern and interest you have demonstrated with these hearings. If you have any questions of me at this time, I would be happy to attempt to answer them. If you or your staff have any further questions after today, or would like expansion of any of the examples used, please contact me at your earliest convenience.

PROFESSIONAL NOTES

SIMPLIFIED SECTION 89 IS STILL A MAJOR HURDLE FOR EMPLOYERS

At least 25% of medium to large employers would fail the simplified Section 89 tests proposed by House Ways and Means Chairman Dan Rostenkowski (D-Ill.), predicts benefits consultant Hay/Huggins Co., Philadelphia. (See "Testing Date Delayed as Congress Considers Easing Section 89," Page 8.)

The current health plans of 10% of all employers would fail at least one of the tests—the maximum employee premium contribution requirement—under the Rostenkowski proposal, says Hay/Huggins. Another 15% would probably fail the requirement within two years.

The bill was submitted in response to complaints from businesses that the requirements of Section 89 are complex and expensive to implement. Section 89 requires employers to prove that their employee benefit plans do not discriminate between nonhighly compensated and highly compensated workers, generally those who are earning more than $54,480 annually.

"Although the bill would eliminate most of the complexity, the tests require that the medical plan provides a maximum employee premium contribution for family coverage of $25 per week or $108 per month," says Hay/Huggins senior vice president Michael Carter. But one in 10 companies now requires employees to contribute more than $108 monthly for family health coverage.

Companies that fail the tests could decrease the employee's contribution; tax all highly compensated employees on the value of their benefits; or offer an additional plan with lower contributions and decreased benefits. Taxing all highly compensated workers on the value of their benefits would lead to $300 to $1,500 or more in taxes for highly compensated workers. To cover this additional tax liability, companies may want to raise salaries for their executives by this amount, says Carter.

Reducing the required employee contributions could be costly and many company health plan costs are already going up by 20% or more annually.

SOME COMPANIES ARE COMPLYING WITH SECTION 89 WHILE OTHERS WAIT FOR RELIEF

Given the tinkering Congress has done with Section 89, it should come as no surprise that many companies are waiting to bring their benefit plans into compliance with the proposed nondiscrimination rules, reveals a survey by Coopers & Lybrand. The survey was sent to benefits professionals at 3,300 large service and industrial companies with at least 1,000 employees. Of the companies that received the survey, 133 (4%) responded.

Here are some of the highlights of the survey:

- Although 77% of the respondents said they intended to test their benefit plans for compliance with the Section 89 rules, 48% said they had not yet determined what compliance strategy to use if their plans are discriminatory. "These companies are hoping for Congressional relief," says Neil Berger, a Coopers & Lybrand partner in New York.
- The most popular approaches among respondents for correcting non-compliance are reporting imputed income for affected highly compensated employees (66%) or both reporting imputed income and raising salaries of affected highly compensated employees to cover the tax (40%). Other remedial compliance methods planned are reducing benefits for highly compensated employees (13%); increasing benefits for nonhighly compensated employees (5%); reducing contributions for nonhighly compensated employees (4%); and increasing contributions for highly compensated employees (11%).
- Most of the companies (78%) reported that their systems did not accurately track the data needed for Section 89 testing. Only 9% said their systems were very accurate or somewhat accurate.
- About 35% of the responding companies were undecided about when they would begin actual testing for compliance with Section 89. Only 2% of respondents said they tested during the first quarter; 16% said they would test in the second quarter; 26% in the third quarter; and 21% in the fourth quarter.

The following types of plans were sponsored by the responding companies: defined benefits plans, 80%; defined contribution plans, 81%; flexible benefits plans, 39%; other group benefits plans, 69%; and incentive stock or bonus plans, 65%. The companies had an average of 8,000 employees, and an average of 44% of their employees were salaried; 58% had hourly employees who are represented by a union. The median number of employees was 3,000.

NEW PRODUCTS AND SERVICES

SOFTWARE

BNA FIXED-ASSET MANAGEMENT SYSTEM enables financial managers to track fixed assets and the corresponding tax rules.

The program computes depreciation expense for books, federal and state tax returns, for AMT and for earnings and profits. It can handle 32 methods of depreciation. It is current through the Technical and Miscellaneous Revenue Act of 1988.

The program requires an IBM PC or compatible; 640K of memory; and a hard disk. Price: $995.

For information: BNA Software, 1231 25th St. N.W., Washington, D.C. 20037, 800/372-1033.

BOTTOMLINE V is a financial planning, analysis, modeling and forecasting system for small to large companies. The program works with most spreadsheets and consists of financial simulation and budget and cash flow models, which include: one-year monthly for short-term planning; two-year quarterly for seasonal projections; five-year annual for long-range planning; historical analysis; five-year projection from historical profit and loss and

PROGRAMS SIMPLIFY SECTION 89 COMPLIANCE

COMPLIANCE 89 eases compliance with Section 89 by performing mathematical nondiscrimination tests on employee benefit plans. The program allows the user to determine which employees are highly compensated, and it tests employee benefit plans to see if they are discriminatory. It includes a legal synopsis, a glossary, answers to common questions about Section 89 and suggestions for bringing noncomplying plans into compliance.

The program runs on IBM PCs or compatibles. Price: $295, Small Business Edition, for as many as 499 employees; $595, Professional/Corporate Edition, for as many as 2,000 employees.

For information: Employee Benefits Review, 715 Eighth St., Washington, D.C., 20003, 202/546-3394.

THE BENEFITS MANAGER is a series of programs that can help companies of every size administer and comply with employee benefits requirements. Modules include: Discrimination Testing, to comply with Section 89 regulations; Flexible Benefits Administration, to maintain employee benefit information and produce enrollment forms and reports; Flexible Spending Account, to prepare detailed reports of the status of cash flexible spending account; and the Defined Benefit Calculation, to calculate accrued benefits.

The Benefits Manager series requires an IBM PC or compatible. Price: Discrimination Testing, $2,500 for single-user version plus $400 for one-year maintenance agreement, $7,000 for multiuser version plus 15% of total module order price for one-year maintenance agreement; Flexible Benefits Administration, $15,000; Flexible Spending Account, $2,500; Defined Benefit Calculation, $2,500.

For information: WTS Data Services Inc., 708 Third Ave., New York, N.Y. 10017, 212/949-1344.

THE TAX AND BUSINESS PROFESSIONALS' SECTION 89 TEMPLATE consists of six Lotus 1-2-3 templates that handle the data necessary to conduct discrimination testing under Section 89. The program is designed for companies with about 30 to 60 employees or more.

The program requires Lotus 1-2-3, an IBM PC or compatible with a hard disk. Price: $299; for an additional charge, capacity can be expanded for companies with more employees.

For information: Tax and Business Professionals, P.O. Box 374, Manassas, Va. 22110, 800/552-6413.

SECTION 89 ANALYZER facilitates data collection and performs discrimination tests for small to large companies. The Data Collection module can be copied and used for gathering data at multiple locations. Data can be downloaded from any payroll system. The Testing module designates who is a highly compensated employee, performs Section 89 tests, shows pass or fail percentages and discriminatory excess and provides a "what-if" capability for redesigning benefit plans.

The program requires an IBM PC or compatible with a hard disk; 640K of memory; and DOS 3.0 or later. Price: $4,950.

For information: Mayer Hoffman McCann, CPAs, 420 Nichols Road, Kansas City, Mo., 800/433-2292 or 816/968-2255.

Senator KASTEN. First of all, thank you for, you are helping right now. We have built, over the last 4 days, an extraordinary record, and a couple of you touched on part-time employees. We had the president of Figi's Cheese; they have regularly 200 or 300 people. During their peak season, they go up to something like 2,800. In order to get to that 2,800, not unlike what Georgia was saying, they employ at least, at one time or another, about 3,200. And it is just that one season, from roughly November through the middle of January.

And they have got people coming in 24 hours a day, from miles around, working part time, some working a 10-hour day, every third day, some working just on Saturdays or just on Sundays. Some coming in at midnight and working till 6. I mean, it is the nature of their business to keep that 800 number going. And if you can imagine what his problems are dealing with who is putting in how many hours when, and this whole group of people all of whom look forward to this part-time employment at this time of the year, but who basically are covered under different kinds of programs. And it was just wild when he started going into what he would have to do in order to comply.

So, we have seen a number of terrific examples. And Nick, thank you for the ones that you have shared with us. And what we have done, I think, is developed a record.

It is so troubling that we talk about the crisis in health care and the desire that this administration, all of us have, to have more people covered by private plans, so that we do not have as many people covered by Medicare, or going without, or going underinsured, and at the same time we end up with this huge disincentive for private industry, particularly small business, to provide for health care coverage. It is absolutely inconsistent with public policy and with desirable social goals for our country.

I am hopeful, too, that we are going to be able to get it repealed. I know, in the testimony all week long, we have had people say we would like it repealed. But I have to be pragmatic, and then this is the worst parts. I think the time to be pragmatic might be in a year or so. But right now, the emphasis has got to be on repeal. And on trying to show how this does not work.

If the issue was equity and providing insurance to as many people as we possibly could, then all of us would be working in that direction. The issue here is increasing taxes without getting blamed for it, and a huge bureaucracy that is absolutely pointless in terms of contributing to, as we say, nonvalue added.

So, let me say thank you to you. I want to thank all of you for being here today. And because this is our last hearing, it is a little bit why we are all kind of bleary eyed over here. We have been on the road. But I want to again. thank the Small Business Administration and, particularly, the Advisory Council, and then, specifically, Bob Miller and Kurt Charter, for working with the Small Business Committee, in organizing this.

I want to thank Rob Gifford and I also want to thank Susan Weitz. I am hopeful that with the work we are doing and with the work that my colleagues are doing—as I said at the outset, other Members of Small Business Committee are doing exactly this. And we are going to develop a record, and I just hope we can make

some common sense out of all this, so that we do have incentives so that people will provide for the best possible coverage for the largest number of people. But not at a cost of $4 billion. And not at the cost of losing health care coverage to so many people that desperately need it.

If this made sense, we would be for it. But we have to figure out a way that makes sense. It would be horrible if we put this into effect, because I am confident that if it ever did go into effect, for sure we would repeal it then, because everyone would be affected. It is hard to talk about something before it happens. But we would be doing a great public service if we could repeal it now, rather than repeal it 1½ years from now. The costs, the legal fees, the time, the problems, the threatened penalties, it would be chaos. And I am confident that we would repeal it under those circumstances, just as I was confident that 10 percent withholding of interest and dividends, simply was not going to sell. We are in exactly the same position. And this time we are a little ahead of the curve, due to your help.

Thank you all very much. This hearing is adjourned.

[Whereupon, at 3:35 p.m., the hearing was adjourned.]

APPENDIX

Valley Bancorporation

100 WEST LAWRENCE STREET P.O. BOX 1061 APPLETON, WISCONSIN 54912-1061 (414) 738-3830

August 14, 1989

The Honorable Senator Robert Kasten, Jr.
United States Senate
110 SHOB
Washington, DC 20510-4901

Dear Senator Kasten:

Valley Bancorporation agrees with your opinion that the repeal of Section 89 would be the most appropriate action. The collection of data and complicated discrimination testing required by this law places significant burden on larger employers and an almost impossible burden on smaller employers.

Valley Bancorporation has approximately 2400 employees and several data items required for Section 89 testing are currently not available on these employees. We would need to survey all employees, compile the data, develop a database, input the data, and train someone to understand and administer the complex, discrimination testing currently required. We estimate that this would require an additional half-time employee for implementation and ongoing administration of Section 89 compliance and discrimination testing.

We believe that the initial intent of the law - to provide health insurance benefits to a broader base of employees nationwide - has been lost in the myriad of other non-related benefits included in the compliance and testing. We also feel that the revenue raising aspects of Section 89 have far over-shadowed the original intent.

Thank you for the opportunity to express our opinions. We look forward to your continued support for repeal of Section 89.

Sincerely,

Charles H. Sauter
Senior Vice President

Sincerely,

Barbara J. Beck
Employee Benefits Manager

BJB:bb

HERITAGE INSURANCE
Heritage Mutual Insurance Company · Sheboygan, Wisconsin 53081

August 9, 1989

The Honorable Robert Kasten
c/o Michael L. Qualio
Sheboygan County Employment
Manager's Association

Dear Senator Kasten:

I am truly sorry that business away from the city does not permit me to attend the public hearing you are holding in Sheboygan regarding Section 89 testing.

I strongly encourage you to eliminate or revise the testing requirements of Section 89 as the cost of meeting the tests is undoubtedly far greater than the abuse Section 89 was intended to prevent.

For example, in my company, all full-time employees are eligible for single health insurance coverage, at no cost, or family coverage at a uniform premium rate for all. In other words, the cost to the company, to the employee, and the benefits to employees and dependents are absolutely identical. Yet, we are now asked to spend an horrendous amount of time and money to prove what we already know--that our group health insurance does not discriminate.

As an employer, I am faced with several choices, all of them undesirable:

1. Hire an outside consultant to perform the testing, at a cost estimated to be between $3,000 and $6,000.

2. Purchase a software program for approximately $1,000 and use valuable employee and computer time which should be spent in our primary business--selling insurance--at a total cost of many thousands of dollars, or;

3. Struggle through the complex instructions and manually performing the testing in an already over-worked human relations department. The process of obtaining affidavits from all single employees who voluntarily decline family coverage and all of the additional steps required are, to say the least, a tremendous burden on our small staff.

I appreciate the reasons for Section 89, and respectfully suggest that the same results could be achieved by revising the law to require a simple affidavit (perhaps added to the annual Form 5500 report on welfare benefits) stating that "Our health insurance program is totally nondiscriminatory. The premiums, cost, and benefits are identical for 95% of our employees." As this would be, in effect, a sworn statement, with appropriate penalties for deliberate misrepresentation, it would achieve the result that Congress intended without the burdensome testing.

In summary, I strongly encourage you to support legislation repealing the testing requirements of Section 89, and am certain that my colleagues share this view.

Yours very truly,

Stanley L. Sisson
Personnel Director

SLS/bjs

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PHONE (414) 467-8167 FAX (414) 467-8169

August 14, 1989

Honorable Robert W. Kasten
110 Hart Senate Office Building
Washington, D. C. 20610

Dear Senator Kasten:

On behalf of our company I would like to present our views on Section 89 at the congressional field hearing in Sheboygan.

Section 89 is a very poor law. The I.R.S. has postponed compliance and both the House and Senate are considering ways to simplify the law. Section 89 is burdensome to small business and stymies entrepeneurship. It is unfair for the government to dictate how companies should spend earningss. SECTION 89 SHOULD BE REPEALED.

A recent article stated Section 89 was slipped into the 1986 Tax reform Act by congressional and treasury department staffers and there was not a single cosngressional house member, congressman or senator, who sponsored it and maybe no one who even read or understood its' provisions.

I understand Rep. John J. La FAlce's (D-32, New York) had 281 cosponsors for his bill HR 634 to repeal Section 89 as of May 5, 1989. Cong. Tom Petri is a co-sponsor.

Senator Trent Lott (R.-Miss.) has introduced a bill to repeal Section 89 and had 31 co-sponsors as of May 5, 1989.

As a small business I am concerned the I.R.S. non-discrimination and qualification rules for Section 89 serve only to complicate compliance procedures. I feel it is a cover for raising tax revenues. Section 89 is a misguided law. It puts health and benefit plans at risk.

Bob Kasten understands business and its' importance to the nation's economy. Business cannot do otherwise but press for repeal of Section 89 and supports Bob Kastens efforts in this regard.

I am grateful for his efforts to delay implemention of Section 89, and to relieve business of this onerous burden to busineses everywhere.

Sincerely yours,

FELDMANN ENGINEERING & MANUFACTURING CO., INC.

Myrtle F. Feldmann

Myrtle F. Feldmann, Vice President

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WISCONSIN FARM BUREAU FEDERATION

7010 Mineral Point Road
P.O. Box 5550
Madison, WI 53705-0550
Area Code (608) 833-8010

August 17, 1989

To: Members of U.S. Senate Small Business Committee

From: Don Haldeman, President

RE: Repeal of Section 89 (Tax Reform Act of 1986)

Mr. Chairman and members of the committee, on behalf of the more than 52,000 member families of the Wisconsin Farm Bureau Federation, I am pleased to provide testimony on Section 89 of the Internal Revenue Code.

The WFBF, like you, Senator Kasten, believes Section 89 needs to be repealed.

The intent of Section 89, when it was included in the Tax Reform Act of 1986 was to encourage employers to provide health insurance for all their employees. While the intent of Section 89 to discourage discrimination between highly compensated employees and lower compensated employees is good, it is too confusing, complex and counterproductive. It is the WFBF's belief that the complexities surrounding Section 89 will actually cause people to drop health insurance.

Why is Section 89 not working? There are several reasons.

Section 89 requires compliance with five qualification criteria. In general the requirements are; 1) the submission of a written plan, 2) employee's rights must be legally enforceable, 3) employee's must be provided with reasonable notification of available benefits, 4) the plan must be maintained for the exclusive benefit of the employees, and, 5) the plan must be established with the intention of being maintained for an indefinite period. It also requires several nondiscrimination rules.

What does this all mean? Let me provide you with a couple examples.

Example 1: An individual owns and operates a farm as a sole proprietor and employs one additional employee who is not related. The owner utilizes only one checking account for all business and personal expenses and maintains health insurance coverage for himself but not his employee. The owner claims no income tax deduction.

Under Section 89 the proprietor who carries personal health insurance coverage maintains an employee benefit plan within the meaning of Section 89, which is subject to the discrimination testing requirements, because a sole proprietor is deemed to be both an employee and an employer. Whether or not the proprietor pays premiums from personal or business funds or claims income tax deductions appear to be inconsequential.

Example 2: If a sole proprietor maintains coverage for himself and an employee as well, he is treated the same as in Example 1.

Since the sole proprietor would be classified as the highly compensated employee, he would have to pay taxes on a portion of his coverage because under Section 89 benefits are not excludable and must be reported as taxable income.

As it is right now a sole proprietor would be unable to purchase health insurance coverage for an employee without having to go through the bureaucratic mess of meeting all the qualifications and nondiscrimination tests provided in Section 89.

The WFBF is concerned that Section 89 will discourage proprietors from getting health insurance coverage for both themselves and their employees. Also, when you combine this issue with the fact that self-employed businessmen are in jeopardy of not being able to deduct health insurance premiums on their tax return, you can see that we have a real problem.

If it is the intent of Congress to expand health insurance coverage in the workforce, the repeal of Section 89 and the approval of a permanent 100 percent tax deduction on health insurance premiums for self-employed individuals is a good start.

524 South Boulevard
Baraboo, WI 53913
Ph. (608) 356 5551
Fax (608) 356 5260
Telex 910 280 2644

August 22, 1989

Senator Robert W. Kasten
SENATE HOUSE 110
Senate Hart Building
Washington, DC 20510

Dear Senator Kasten:

On behalf of the Nordic Group of Companies, headquartered in Baraboo, Wisconsin, I would like to comment in regard to your Section 89 hearings which recently involved a session at Madison on the 17th of August, 1989.

I was able to be in attendance at that session and was encouraged by both the comments of the participants who had preregistered to be heard as part of the hearing (regrettably I was unable to preregister or I would have submitted comments at that time) and by yourself, indicating a solid grasp of the economic realities and impact of this legislation. Based upon what I heard, my comments would be largely reinforcing rather than new and different, but then accumulation and weight does have its positive value also.

The Nordic Group of Companies is composed of many manufacturing and service businesses in many locations around the country as noted on the bottom of our letterhead. Some of those companies, in turn, are a composite of acquisitions over various periods of time. In view of Section 89's efforts to impose administrative burdens upon companies for compliance and reporting purposes, we face a particularly expensive task while anticipating no return for the investment from a value added and, therefore, job creating perspective.

In fact, as you pointed out in your comments to the media following the formal portion of the hearing last Thursday in Madison, these types of expenses detract from income and, therefore, tax payments and make these companies, ours and all others, less competitive because of having to spend non-value added effort which foreign competition obviously need not do.

It seems only fair to describe the actions of the Congress in passing this legislation as a shirking of their responsibilities from two perspectives. First of all, if the objective is to raise taxes, then they ought to raise taxes in the way that is least harmful to our competitive position (I don't believe any increase is helpful). Second of all, if the objective is to provide real and long lasting benefit to the employees of companies in the United States, members of Congress should have the courage to publicly face up to the reality, which I hope most of them know in their own minds, that real and lasting improvements to compensation, including fringe benefits, come only from increases in the cost effective production of quality products for the marketplace. Just the opposite ultimately occurs when costs are forced upon business which have no basis in productivity and quality of product.

Best of success in your continuing efforts to search out the facts out in the trenches.

Respectfully submitted,

NORDIC GROUP OF COMPANIES

Richard T. Koenings
Vice President

RTK/alv

cc: Mr. W. R. Sauey - Chairman - NORDIC GROUP OF COMPANIES

August 15, 1989

KOHLER

Senator Kasten:

I am Dan DeBaker the Corporate Employee Benefits Manager for the Kohler Co., headquartered in Kohler, WI. Kohler Co. is a manufacturer of plumbing products, four cycle engines, stand-by generator sets and home furniture, with over 14,000 employees world wide.

We appreciate the opportunity today to comment on Section 89 of the Tax Reform Act of 1986.

I believe we can say with confidence that never in the history of Employee Benefits legislation has a law been as difficult to comprehend, expensive to comply with, and impossible to know if you are in compliance.

The Kohler Co. in its initial attempts to evaluate the new law, spent $100,000 in outside consulting help and spent again as much money internally. We had to marshal the Personnel, Systems, and Accounting people throughout the Kohler Co. to develop the data base necessary to conduct the required tests. In the summer of 1988 we had an all day conference of Kohler Co. and its subsidiaries' team members assigned to Section 89 compliance. This conference alone cost Kohler Co. tens of thousands of dollars.

Even more frustrating was that all this effort was useless. It became apparent the legislation was going to change, and we called off further work on Section 89 compliance until the legislative picture becomes clearer. What work has been done was performed in a state of confusion.

From what we understand, this legislation is intended to encourage the expansion of benefit coverage for non-highly compensated employees, and as a side benefit generate some taxable income from highly compensated employees. We believe you're going to see, in many cases, just the opposite impact.

1. The Kohler Co. has approximately 140 health plans. There are numerous different plans because of acquisitions and no systematic way of collecting data to conduct tests. What electronic systems exist are diverse and non-compatible and in most cases only manual record keeping systems exist to generate the 55 data elements necessary on each employee. The administrative burden is incredibly expensive. You will see the cost of administering Section 89 reduce Kohler Co. taxable income. There will be no compensating benefit to the government because our benefit plans are offered equally to all employees with the only difference driven by local labor market conditions or labor bargaining contracts.

   In other words, Section 89 will not cause us to re-design our plans, but will increase our cost of operations; thereby, reducing taxes paid to the government, and reducing our competitiveness abroad.

2. Current Section 89 rules apply to plans that are a part of labor contracts and this will have a major disruptive influence on labor relations. Unions representing their members will have trouble allocating monies toward wage increases and unregulated benefits as Section 89 may force employers to negotiate regulated benefits. An example is group life insurance. Most unions are not keen on group life insurance benefits, but under the current Section 89 rules is required to be tested.

With employers' budgets constrained by competitors, dollars will now be allocated from taxable income to tax exempt benefits. Clearly unions and companies should be free to negotiate whatever compensation and benefit package they wish without the regulatory constraints of Section 89.

There are numerous rules and regulations that do not make sense and will cause major business problems. For example, the Kohler Co. operates a hospitality business in the Kohler area employing close to 1,000 people and having a substantial positive economic impact on the community. Employee Benefits in the hospitality industry are significantly different than those of a heavy manufacturing company like the Kohler Co. Yet, under Section 89, because this hospitality business is located at the same site as the corporate headquarters, we are not allowed to treat it as a separate line of business. The hospitality business cannot afford to provide manufacturing level benefits, and we would be forced to limit our plans for growth in this business.

Senator Kasten, we applaud your efforts to have Section 89 repealed. It may be a well-intentioned law, but the costs far outweigh the benefits and certainly a more effective program can be developed to accomplish the Congress' intentions. At the very least, Congress should modify Section 89 to ease the complex administrative burden and postpone the effective date until definitive regulations can be drafted. This would enable employers to prepare for the administration of the law and have some confidence they are complying with the law when they are finished.

Sincerely,

Daniel A. DeBaker
Manager - Employee Benefits

DAD/dcb